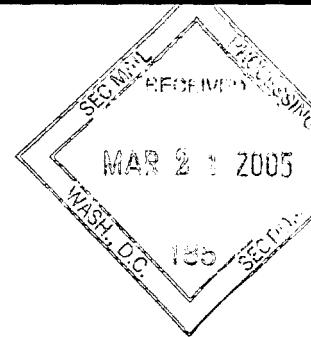




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**BankMutual**  
CORPORATION

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*12-31-04*

**NOTICE OF 2005 ANNUAL MEETING OF SHAREHOLDERS**

**PROXY STATEMENT**

**2004 FORM 10-K ANNUAL REPORT**

**PROCESSED**

**MAR 22 2005**

**THOMSON  
FINANCIAL**



March 11, 2005

Dear Fellow Shareholder,

We invite you to attend the Bank Mutual Corporation 2005 Annual Meeting of Shareholders, which will be held at the Four Points Sheraton Milwaukee North Hotel, 8900 N. Kildeer Court, Milwaukee, Wisconsin at 10:00 a.m., Central Time, on Monday, May 2, 2005.

Bank Mutual Corporation's Notice of Annual Meeting of Shareholders and Proxy Statement which are enclosed describe the business to be conducted at the Annual Meeting. If you plan to attend the Annual Meeting, please check the box on the proxy form so that we can make the appropriate arrangements.

Also enclosed is a copy of Bank Mutual Corporation's Summary Annual Report and attached to this Proxy Statement is the Annual Report on Form 10-K for the year ended December 31, 2004.

**YOUR VOTE IS VERY IMPORTANT.** Whether or not you plan to attend the Annual Meeting, we urge you to **mark, sign, date and return your proxy form in the enclosed postage-paid envelope as soon as possible** to make sure that you are represented. This will not prevent you from voting in person at the Annual Meeting, but will ensure that your shares will be represented if you are unable to attend.

Sincerely,

**BANK MUTUAL CORPORATION**

**MICHAEL T. CROWLEY, JR.**

Chairman, President and Chief Executive Officer

**BANK MUTUAL CORPORATION**

**4949 West Brown Deer Road  
Milwaukee Wisconsin 53223  
(414) 354-1500**

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**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS  
TO BE HELD ON MAY 2, 2005**

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To the Shareholders of Bank Mutual Corporation:

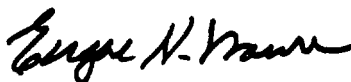
The 2005 annual meeting of shareholders of Bank Mutual Corporation will be held on Monday, May 2, 2005, at 10:00 a.m., Central Time, at the Four Points Sheraton Milwaukee North Hotel, 8900 N. Kildeer Court, Milwaukee, Wisconsin for the following purposes:

- (1) Electing three directors to serve for terms expiring in 2008 and one director for a term expiring in 2007;
- (2) Ratifying the selection of Ernst & Young LLP as independent auditors; and
- (3) Transacting such other business as may properly come before the annual meeting or any adjournment thereof.

The board of directors has fixed the close of business on March 3, 2005 as the record date for the determination of shareholders entitled to notice of and to vote at the annual meeting and any adjournment thereof. Only shareholders of record at the close of business on that date will be entitled to vote at the annual meeting.

We call your attention to the proxy statement accompanying this notice for a more complete statement regarding the matters to be acted upon at the annual meeting. Please read it carefully.

By Order of the Board of Directors



Eugene H. Maurer, Jr.  
Senior Vice President and Secretary

Milwaukee, Wisconsin  
March 11, 2005

**YOUR VOTE IS IMPORTANT**

Your vote is important regardless of the number of shares you own. Whether or not you expect to attend the annual meeting, please indicate your voting directions, sign, date and promptly return the accompanying proxy, which is solicited by the Bank Mutual Corporation Board of Directors, using the enclosed self-addressed envelope, which requires no postage if mailed in the United States. If for any reason you should desire to revoke your proxy, you may do so at any time before it is voted at the annual meeting.

## PROXY STATEMENT

### BANK MUTUAL CORPORATION

4949 West Brown Deer Road  
Milwaukee, Wisconsin 53223  
(414) 354-1500

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### SOLICITATION AND VOTING

This proxy statement and accompanying proxy are furnished to the shareholders of Bank Mutual Corporation ("Bank Mutual Corporation" or the "Company") in connection with the solicitation of proxies by Bank Mutual Corporation's board of directors for use at the annual meeting of Bank Mutual Corporation shareholders on Monday, May 2, 2005, and at any adjournment of that meeting. The 2004 summary annual report to shareholders, which accompanies this proxy statement, and the 2004 annual report on Form 10-K, attached hereto, contain financial statements and certain other information concerning the Company. We are mailing the proxy materials to shareholders beginning on or about March 18, 2005.

*Record Date and Meeting Information.* The board of directors has fixed the close of business on March 3, 2005 as the record date for the determination of shareholders entitled to notice of and to vote at the annual meeting and any adjournment thereof. Only holders of record of Company common stock, the only class of voting stock of Bank Mutual Corporation outstanding, on the record date are entitled to notice of and to vote at the annual meeting. Each share of common stock is entitled to one vote. At the record date, there were 68,964,713 shares of common stock validly issued and outstanding.

The board of directors of Bank Mutual Corporation knows of no matters to be acted upon at the annual meeting other than as set forth in the notice attached to this proxy statement. If any other matters properly come before the annual meeting, or any adjournment thereof, it is the intention of the persons named in the proxy to vote such proxies in accordance with their best judgment on such matters.

*Voting Your Shares.* Any shareholder entitled to vote at the annual meeting may vote either in person or by a properly executed proxy. Shares represented by properly executed proxies received by Bank Mutual Corporation will be voted at the annual meeting, or any adjournment thereof, in accordance with the terms of such proxies, unless revoked. If no voting instructions are given on a properly executed proxy, the shares will be voted FOR the election of management's director nominees and FOR ratification of Ernst & Young LLP as independent auditors.

A shareholder may revoke a proxy at any time prior to the time when it is voted by filing a written notice of revocation with the corporate secretary of the Company, by delivering a properly executed proxy bearing a later date or by voting in person at the annual meeting. Attendance at the annual meeting will not in itself constitute revocation of a proxy.

*Shares in Dividend Reinvestment or Employee Plans.* If a shareholder participates in the Company's Dividend Reinvestment and Stock Purchase Plan (the "DRP"), the proxy also will serve as voting instructions for the participant's shares held in the DRP. Participants' shares will be voted by the administrator of the DRP in accordance with those voting instructions. If a participant does not return a proxy, the DRP administrator will not vote that participant's shares held in the DRP.

Any shareholder who owns shares through an investment in the Company Common Stock Fund of the Bank Mutual Corporation 401(k) Plan (the "401(k) Plan") will receive a separate blue proxy card, marked "401k," to instruct the 401(k) Plan's administrator how to vote those shares. The administrator will vote shares in those participants' 401(k) Plan accounts in accordance with the voting instructions on the proxies. If a 401(k) Plan participant does not return a proxy, the administrator will vote that participant's shares in the 401(k) Plan in the same proportion as the voting of all shares in the 401(k) Plan for which voting instructions have been received.

Any shareholder who owns shares through an allocation to that person's account under the Bank Mutual Corporation Employee Stock Ownership Plan (the "ESOP") will receive a separate green proxy card, marked "ESOP," to instruct the ESOP's administrator how to vote those shares. The ESOP administrator, which is Bank Mutual Corporation acting through its board, will vote shares allocated to those participants' ESOP accounts in accordance with the participant's voting instructions on the proxies. The ESOP administrator may vote, at its discretion, unallocated ESOP shares and any allocated ESOP shares which are not voted by the individuals to whom they are allocated. It is expected that those shares will be voted for all nominees and proposals.

*Quorum and Required Vote.* A majority of the votes entitled to be cast by the shares entitled to vote, represented in person or by proxy, will constitute a quorum of shareholders at the annual meeting. Shares for which authority is withheld to vote for director nominees and broker non-votes (i.e., proxies from brokers or nominees indicating that such persons have not received instructions from the beneficial owners or other persons entitled to vote shares as to a matter with respect to which the brokers or nominees do not have discretionary power to vote) will be considered present for purposes of establishing a quorum. The inspectors of election appointed by the board of directors will count the votes and ballots at the annual meeting.

A plurality of the votes cast at the annual meeting by the holders of shares of common stock entitled to vote is required for the election of directors. In other words, the individuals who receive the largest number of votes are elected as directors up to the maximum number of directors in a class to be chosen at the annual meeting. With respect to the election of directors, any shares not voted, whether by withheld authority, broker non-vote or otherwise, will have no effect on the election of directors except to the extent that the failure to vote for an individual results in another individual receiving a comparatively larger number of votes.

*Expenses and Solicitation.* Expenses in connection with the solicitation of proxies will be paid by the Company. Proxies will be solicited principally by mail, but may also be solicited by the directors, officers and other employees of the Company in person or by telephone, facsimile or other means of communication. Those directors, officers and employees will receive no compensation therefor in addition to their regular compensation, but may be reimbursed for their related out-of-pocket expenses. Brokers, dealers, banks, or their nominees, who hold common stock on behalf of another will be asked to send proxy material and related documents to the beneficial owners of such stock, and the Company will reimburse those persons for their reasonable expenses.

*Corporate Background.* Bank Mutual Corporation is a Wisconsin-chartered corporation which is the successor pursuant to a restructuring transaction of the federally-chartered mutual holding company subsidiary holding company of the same name. In October 2003, the mutual holding company form of ownership ended, and Bank Mutual Corporation became a fully shareholder-owned corporation. All share information in this proxy statement has been adjusted to reflect the related conversion of each old share of Company common stock into 3.6686 shares of new common stock. In this proxy statement: "Bank Mutual Corporation" and the "Company" refer to both the new Wisconsin-chartered corporation and to its federally-chartered predecessor; the "Bank" refers to its subsidiary bank, named "Bank Mutual" (formerly named "Mutual Savings Bank"); "First Northern" refers to First Northern Savings Bank, which was a Company subsidiary until it was merged into the Bank in March 2003; and the "MHC" refers to Bank Mutual Bancorp, MHC, the former mutual holding company of Bank Mutual Corporation.

## SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS

The table below sets forth information regarding the beneficial ownership of Bank Mutual Corporation common stock as of the date hereof by each director and nominee for director, by each executive officer named in the Summary Compensation Table below and by all directors and executive officers of the Company as a group. The table also includes information as to the only known 5% or greater shareholder of the Company.

Name of Beneficial Owner	Number of Shares and Nature of Beneficial Ownership (1)(2)	Percent of Class
P. Terry Anderegg.....	303,655	*
Thomas H. Buestrin.....	213,206	*
Christopher J. Callen.....	295,851	*
Rick B. Colberg.....	313,857	*
Michael T. Crowley, Jr.....	1,884,617	2.8%
Raymond W. Dwyer, Jr.....	91,831	*
Mark C. Herr.....	117,603	*
Thomas J. Lopina, Sr. ....	236,914	*
Eugene H. Maurer, Jr. ....	297,782	*
William J. Mielke.....	319,459	*
Robert B. Olson.....	513,463	*
David J. Rolfs.....	145,091	*
J. Gus Swoboda.....	248,289	*
All directors and executive officers		
as a group (14 persons) (3)(4) .....	7,091,056	10.2%
Michael T. Crowley, Sr. (5) .....	357,339	*
Advisory Research, Inc (6). ....	4,256,350	6.3%

\* Less than 1.0%. Percentages are based on shares outstanding on the date hereof.

- (1) Unless otherwise noted, the specified persons have sole voting and dispositive power as to the shares. Beneficial ownership of the following shares is shared: Mr. Buestrin – 69,823 shares; Mr. Crowley Jr. – 84,570; Mr. Dwyer – 9,314; Mr. Lopina – 31,213; Mr. Olson – 395,760; Mr. Rolfs – 42,188; Mr. Swoboda – 119,977; group – 2,633,656; Mr. Crowley Sr. – 3,668. See also notes (3) and (4) below.
- (2) Includes the following shares subject to options granted under the Company's 2001 Stock Incentive Plan (the "2001 Plan") or the 2004 Stock Incentive Plan (the "2004 Plan") exercisable within 60 days of the date hereof: Messrs. Anderegg, Callen and Maurer – 152,068 shares each; Messrs. Buestrin, Mielke, Olson and Swoboda – 74,697 each; Mr. Colberg – 147,568; Mr. Crowley Jr. – 586,432; Messrs. Dwyer, Lopina and Rolfs – 30,674 each; Mr. Herr – 67,590; all directors and executive officers as a group – 1,797,922; Mr. Crowley Sr. – 89,372. All restricted shares awarded under the 2001 and 2004 Plans, whether or not vested, are included as beneficially owned because recipients have voting rights as to them.
- (3) The total for the group (but not any individual) includes 1,762,614 unallocated shares held in the ESOP, as to which voting and dispositive power is shared. As administrator, the Company (through its Board) may vote, in its discretion, shares which have not yet been allocated to participants. Employees may vote the shares allocated to their accounts; the administrator will vote unvoted shares in its discretion. Allocated shares are included only if allocated to named executive officers, in which case they are included in those individuals' (and the group's) beneficial ownership. Also includes 61,246 shares held under the Benefit Restoration Plan in which officers share beneficial ownership of shares held for the accounts of others.
- (4) Because the 401(k) Plan permits participants to vote shares and make investment decisions, except for certain takeover offers, shares held in the 401(k) Plan are included only if held in the accounts of named persons, even though certain of the officers are trustees or administrators of one of the plans.
- (5) Mr. Crowley Sr. retired as a director of the Company on December 31, 2004. He is not an executive officer of the Company, but remains Chairman, a director and an employee of the Bank.

- (6) In a report on Schedule 13G filed on February 15, 2005, Advisory Research, Inc. reported sole voting power and sole dispositive power as to 4,236,350 shares of Company common stock. Advisory Research, an investment advisor, is located at 180 North Stetson Street, Suite 5500, Chicago IL 60601.

The above beneficial ownership information is based on data furnished by the specified persons and is determined in accordance with Rule 13d-3 under the Securities Exchange Act, as required for purposes of this proxy statement. It is not necessarily to be construed as an admission of beneficial ownership for other purposes.

### **ELECTION OF DIRECTORS**

The bylaws provide that the number of directors of Bank Mutual Corporation shall be between seven and thirteen, as determined by the board of directors. At each annual meeting the term of office of one class of directors expires and a class of directors is elected to serve for a term of three years or until their successors are elected and qualified. At this time, board has set the number of directors at nine. Messrs. Herr, Lopina, Olson and Rolfs, the directors whose terms expire at the annual meeting, are being nominated for re-election as directors.

Michael T. Crowley Sr., a director of the Company since its formation in 2000 and an employee, director and/or executive officer of the Bank for over 70 years, retired on December 31, 2004 as a director of the Company. The Board of Directors wishes to thank Mr. Crowley Sr. for his service to the Company. While the Board will miss his counsel as a director of the Company, Mr. Crowley Sr. remains a director and executive officer of the Bank.

The Company's bylaws require that each of the three classes of directors be as nearly equal in number as possible. Mr. Crowley Sr. was previously a director in the class whose term expires at the 2007 annual meeting. Since the Board has determined not to propose at this time a new nominee for the position left unoccupied as a result of his retirement, the three classes became unequal in size. To equalize the classes, Mr. Herr, whose term expires at the 2005 annual meeting, has agreed to stand for election for the class of directors whose terms will expire at the 2007 annual meeting rather than standing for the class whose term expires in 2008. If elected, the other three nominees will continue in the class whose terms expire in 2008. Under the bylaws, the board may appoint a new director to fill a vacancy which occurs between annual meetings, including a vacancy which would result from a later determination to increase the size of the board.

Shares represented by proxies will be voted FOR the election of the nominees unless otherwise specified by the executing shareholder. If any nominee declines or is unable to act as a director, which we do not foresee, proxies may be voted with discretionary authority for a substitute nominee designated by the board. Information regarding the nominees and the directors whose terms continue is set forth in the following table. The board of directors unanimously recommends that shareholders vote FOR the election of the director nominees listed below.

<u>Name and Age</u>	<u>Principal Occupation and Business Experience (1)</u>	<u>Director Since (2)</u>
<i>Nominees for Terms expiring in 2008</i>		
Thomas J. Lopina, Sr. 67 (3)	Associate, Spectrum Solutions, Inc., small business consulting firm	1979
Robert B. Olson, 67 (4)	Consultant (self-employed); prior to 2000, Executive Vice President, Vice President of Operations and other officer positions, Little Rapids Corporation, specialty paper producer	1997
David J. Rolfs, 83 (3) (4) (5)	Retired; prior thereto, president of ABCO Dealers Inc., health care industry	1984
<i>Nominee for Term expiring in 2007</i>		
Mark C. Herr, 52	Partner, Plunkett Raysich Architects LLC (7)	2001

<u>Name and Age</u>	<u>Principal Occupation and Business Experience (1)</u>	<u>Director Since (2)</u>
<i>Continuing Directors—Terms expire in 2006</i>		
Thomas H. Buestrin, 68 (4)	President of Buestrin, Allen & Associates Ltd., real estate investment, management and development	1995
Michael T. Crowley, Jr., 62 (6)	Chairman and CEO of the Company since 2000, and President since 2003; President and CEO of the Bank (8) (9)	1970
William J. Mielke, 57 (3) (4) (5)	President and CEO of Ruekert & Mielke Inc., engineering	1988
<i>Continuing Directors - Terms expire in 2007</i>		
Raymond W. Dwyer, Jr., 81 (3) (5) (6)	Retired; prior thereto architect with R.W. Dwyer Architects	1957
J. Gus Swoboda, 70 (5) (6)	Retired; prior thereto, Senior Vice President, Human and Corporate Development, Wisconsin Public Service Corporation, electric and gas utility	1987

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- (1) Unless otherwise noted, all directors have been employed in their respective principal occupations listed for at least the past five years.
  - (2) Indicates the date when director was first elected to the board of the Company, the Bank or First Northern, as the case may be. Each of these persons, other than Mr. Herr, became a director of the Company in 2000.
  - (3) Member of the Compensation Committee, of which Mr. Rolfs is Chairman.
  - (4) Member of the Audit Committee, of which Mr. Mielke is Chairman.
  - (5) Member of the Nominating Committee, of which Mr. Mielke is chairman.
  - (6) Member of the Executive Committee, of which Mr. Crowley Jr. is Chairman.
  - (7) From time to time, Plunkett Raysich Architects LLC and its affiliates provide services to the Bank. See "Certain Transactions with the Company – Architectural Fees."
  - (8) Also was a director of PULSE EFT Association, an ATM network operator of which the Bank was a member until PULSE's sale in January 2005.
  - (9) Mr. Crowley Sr., formerly a director of the Company and remaining as Chairman and a director of the Bank, is the father of Mr. Crowley Jr. As a consequence of Mr. Crowley Sr.'s service on the Company's board in 2004, his compensation information is included in this proxy statement. Michael T. Crowley III, the adult son of Mr. Crowley Jr., is the Vice President/Bank Office Administration/Southeast Region of the Bank. In 2004, his salary was \$76,900, plus a bonus of \$11,362 under the Bank's incentive plan; he also participates in other Bank benefit plans. In 2004, Mr. Crowley III also received options to purchase 20,000 shares at \$10.673 per share and 8,000 shares of restricted stock under the 2004 Plan. Mr. Crowley III does not have an employment agreement.

#### **Board Meetings and Committees**

The Bank Mutual Corporation board of directors met four times during 2004. Messrs. Buestrin, Dwyer, Lopina, Mielke, Olson, Rolfs and Swoboda are considered "independent" under Nasdaq Stock Market rules, and all members of the Audit, Compensation and Nominating Committees are "independent." As part of the board meetings, independent directors regularly met without management or non-independent directors present. Each director attended at least 75% of the total of the number of meetings of the board and the number of meetings of all committees of the board on which such director served during the year.



The Audit Committee met six times in 2004. On behalf of the Audit Committee, Mr. Mielke, its chair, also regularly consulted with the independent auditors about the Company's periodic public financial disclosures, and participated in ten calls relating to SEC documents and financial disclosures. See also "Report of the Audit Committee" and "Independent Auditors" for other information pertaining to the Audit Committee.

The Board believes that all of the members of the Audit Committee have sufficient experience, knowledge and other personal qualities to be "financially literate" and be active, effective and contributing members of the Audit Committee. For example, Mr. Buestrin was for seven years a member of the board of directors of the Federal Home Loan Bank of Chicago, and served for several years on its audit committee and, at its request, on the boards of several savings institutions. Both Messrs. Mielke and Buestrin have served as executive officers of their companies, and in those positions have regularly had responsibility for their companies' financial affairs as well as financial matters for projects undertaken by their companies. Mr. Olson has served as an executive officer of a manufacturing company, and for many years was the chief operating officer of one of its divisions. As such, Mr. Olson had primary responsibility for financial performance and reporting of that division. Mr. Rolfs has also occupied executive positions which have included financial elements. While all the members of the Audit Committee have substantial experience and knowledge, and at least Messrs. Mielke, Buestrin and Olson are "financially sophisticated" within Nasdaq Stock Market rules, the Board does not believe that any of these members meet the SEC's specific definition of "audit committee financial expert." However, the Board believes that because the members have qualities and experience which are not captured within the specific definition, and because of their past effectiveness as members of the Board and the Committee, it is appropriate that the Audit Committee not have such an "audit committee financial expert" under the current conditions and circumstances and that the board not add a member simply to include another person who would fit within that particular definition.

The Compensation Committee held five meetings during 2004. The Compensation Committee reviews, and either establishes or recommends to the board: compensation policies and plans; salaries, bonuses and benefits for all officers; salary and benefit levels for employees; determinations with respect to stock options and restricted stock awards; and other personnel policies and procedures. See also "Compensation Committee Report" and "Compensation Committee Interlocks and Insider Participation" under "Executive Compensation" for other information pertaining to the Compensation Committee.

The Nominating Committee met once in 2004. The Nominating Committee considers nominees for director positions and also evaluates and oversees some other corporate governance and related issues. The Nominating Committee will identify nominees based upon suggestions by outside directors, management members and/or shareholders. The selection criteria for membership on Bank Mutual Corporation's board of directors, which were confirmed by the board in connection with the formation of the Nominating Committee, include: strength of character and judgment; honesty and integrity; a diversity of education and experience with business and other organizations; and interplay of the candidates' experience with the experience of other board members. Nominees must have a background which demonstrates an understanding of business and financial affairs. A first-time nominee should be highly respected and active in his profession. A nominee must be a Company shareholder, and the willingness to hold a significant position in Company stock will be considered. A nominee must be capable and able to work well with other directors and management and be able to spend the time needed to function effectively as a director. The nominee must have a genuine interest in representing the interests of the Company and the shareholders overall, not any particular interest group. The nominee should not have conflicts of interest which would interfere with that person's duty of loyalty. The Company has not paid any third party fee to assist in the process of identifying or evaluating director nominees.

The Nominating Committee will consider proposed nominees whose names are submitted to it by shareholders, and it does not intend to evaluate proposed nominees differently depending upon who has made the proposal. If a shareholder wishes to suggest a proposed name for Committee consideration, the name of that nominee and related personal information should be forwarded to the Nominating Committee, in care of the corporate Secretary, at least five months before the next annual meeting to assure time for meaningful consideration by the Committee. However, the Committee has not adopted a more formal process for that consideration because it believes that an informal consideration process is likely to be adequate given the lack of suggestions received in the past. The Committee intends to review periodically whether a more formal policy should be adopted. See also "Shareholder Proposals and Notices" for bylaw requirements for nominations. The Company has not received any

proposed nominees which have been suggested by eligible 5%-or-greater security holders contemplated by relevant SEC disclosure requirements, or rejected any such nominees.

The Executive Committee, which also included Mr. Crowley Sr., did not meet in 2004. The Executive Committee may act on most matters on behalf of the entire board when action is necessary or appropriate on short notice between board meetings.

Bank Mutual Corporation has adopted charters for the Audit, Compensation and Nominating Committees. The Company will continue to respond to and comply with SEC and Nasdaq Stock Market proposals relating to board committees as they are finalized, adopted and become effective. The Company posts copies of the charters for its Audit, Compensation and Nominating Committees (including director selection criteria) and other corporate governance documents on its website, at [www.bankmutualcorp.com](http://www.bankmutualcorp.com), under the link "Corporate Governance." If any of those documents are changed, or related documents adopted, those changes and new documents will be posted on the Company's corporate website at that internet address.

#### **Other Board and Corporate Governance Matters**

*Communications between Shareholders and the Board.* Any shareholder communication which is sent to the board in care of the Chief Executive Officer, corporate Secretary or another corporate officer is forwarded to the board, unless the communication relates specifically to a customer inquiry or complaint in which shareholder status is not relevant. The Chief Executive Officer and the corporate Secretary have been given the authority to conduct that screening process and make that determination. The procedure has been unanimously approved by the board, and was specifically approved by its independent members. Unless and until any other more specific procedures are developed and posted on the Company corporate website, any communications to the board of directors should be sent to it in care of the Chief Executive Officer or the corporate Secretary.

*Director Attendance at Annual Shareholders' Meeting.* Bank Mutual Corporation expects all of its directors to attend the annual meeting of shareholders. A board meeting is also held immediately after the annual shareholders' meeting to facilitate directors' attendance at both. All directors attended the 2004 annual meeting of shareholders.

*Code of Ethics.* As a long-standing part of its and the Bank's corporate governance practices, the Bank has had for many years a code of ethics. Bank Mutual Corporation has built on that code to reflect current circumstances and SEC and Nasdaq definitions for such codes, and has adopted a vision statement and a code of ethics for itself, the Bank and other subsidiaries. Among other things, the code of ethics and code of conduct include provisions regarding honest and ethical conduct, conflicts of interest, full and fair disclosure, compliance with law, and reporting of and sanctions for violations. The codes apply to all directors, officers and employees of Bank Mutual Corporation and subsidiaries. The Company has posted copies of its vision statement and code of ethics, including the related code of conduct, on its corporate website, at [www.bankmutualcorp.com](http://www.bankmutualcorp.com), under the link "Corporate Governance." If further matters are documented, or if those documents (including the code of ethics and the code of conduct) are changed, waivers from the code of ethics or the code of conduct are granted, or new procedures are adopted, those new documents, changes and/or waivers will be posted on the corporate website at that internet address.

## DIRECTORS' COMPENSATION

### Meeting Fees

*The Company.* In 2004, Bank Mutual Corporation's directors who are not officers received a \$12,000 annual retainer for serving as a member of the Board of Directors. Each director also received a fee of \$1,200 per board meeting attended, and each non-officer director received a \$500 fee for each meeting attended of a committee of which the director is a member. For purposes of fees, meetings include conference calls in which committee chairs and/or other representatives participate to review Company disclosures and filings. The current fees remain in effect for 2005, except that the Chairman of the Audit Committee will now receive \$1,000 for each meeting. Some directors of the Company also serve as a director of the Bank; compensation for service on the Bank's Board of Directors is described below.

*The Bank.* The Bank does not pay a retainer fee to its directors. Each director received a \$1,000 fee for each board meeting attended. In 2004, each non-officer received a \$1,000 fee for attending an executive committee meeting. For 2005, the fees remain unchanged. Messrs. Buestrin, Crowley Jr., Crowley Sr., Dwyer, Herr, Mielke and Rolfs were directors of the Bank, and Messrs. Crowley Jr., Crowley Sr., Buestrin, Dwyer and Rolfs were members of the Bank's executive committee, in 2004; all continue as such in 2005.

### 2001 and 2004 Stock Incentive Plans

Bank Mutual Corporation directors are eligible to participate in the 2001 Plan and the 2004 Plan. Pursuant to each of these plans and OTS regulations, no individual may receive more than 25% of the shares which can be issued under the 2001 Plan on the 2004 Plan, and non-employee directors as a group are limited to not more than 30% of the shares which can be issued under either plan, and individually to not more than 5%. In 2004, each non-employee director and Mr. Crowley Sr. received 32,000 shares of restricted stock, with a value of \$10.673 per share on the date of grant, and options to purchase 80,000 shares at \$10.673 per share, under the 2004 Plan. There were no grants or awards to directors in 2002 or 2003. See "Executive Compensation" for grants to Mr. Crowley Jr. and other executive officers. The options and grants vest 20% per year, becoming fully vested after five years, subject to accelerated vesting in the event of a change in control, death or disability, and the administering committee's discretion under the 2001 Plan to waive conditions to exercise.

### Deferred Plans for Directors

*The Bank.* The Bank maintains a deferred retirement plan for non-officer directors. Non-officer directors of the Bank who have provided at least five years of service will be paid \$1,000 per month for 10 years (or, if less, the number of years of service on the board) after their retirement from the Bank board or age 65, whichever is later. All of the existing eligible directors' benefits (other than Mr. Herr's) have vested. In the event a director dies prior to completion of these payments, payments will go to the director's heirs. The Bank has funded these arrangements through "rabbi trust" arrangements, and based on actuarial analyses believes these obligations are adequately funded. The Bank's directors' deferred retirement plan includes provisions whereby the directors may forfeit their benefits for matters specified in the plan which are adverse to the Bank. The plan may be amended by the Bank's board of directors, although a plan amendment may generally not impair the rights of persons who are receiving benefits under the plan.

*First Northern.* A similar plan of First Northern terminated upon its merger into the Bank in 2003. Messrs. Lopina, Olson and Swoboda have vested benefits under that plan, but will not accrue further benefits. That plan provides for monthly payments of \$1,000 for 180 months or until the director's death if earlier. If the director dies after benefits have commenced, but prior to the receipt of 36 monthly payments, the benefit will continue to the director's beneficiary for the duration of the 36-month period. Payments under that plan began in 2003 to Messrs. Lopina, Olson and Swoboda as a consequence of the merger of First Northern into the Bank.

*Crowley Sr. Deferred Compensation Agreement.* The Bank has maintained a deferred compensation arrangement with Mr. Crowley Sr. for over 20 years under which it agreed to defer part of Mr. Crowley Sr.'s compensation in exchange for compensation payments at the later date. The precise provisions have been modified

from time to time, most recently in 1998. To fund this obligation, the Bank purchased a life insurance policy on Mr. Crowley Sr. The policy is fully paid, and the Bank believes the arrangement is fully funded.

Upon Mr. Crowley Sr.'s retirement, he will receive a life income in monthly installments, with a minimum of 240 installments. The monthly installments will be equal to the amount that would be payable to the Bank under the life insurance policy if the Bank were to exercise a settlement option under the policy for monthly life income, with a 240 month period certain, with payments commencing as of the date of Mr. Crowley Sr.'s retirement. If Mr. Crowley Sr. were to die before retirement or receipt of 240 monthly payments, the amounts otherwise payable to him will be paid in equal shares to his two children (including Mr. Crowley Jr.) or to their survivors. Under certain circumstances, the Bank may elect to make a lump sum or other type of payment to Mr. Crowley Sr. or his heirs, which would be based upon other forms of payment which may be available under the life insurance policy.

#### **Other**

See "Executive Compensation" for compensation paid to, and other compensatory agreements with, Messrs. Crowley Sr. and Crowley Jr. as current or former executive officers and employees of Bank Mutual Corporation, the Bank and/or the MHC. Although Mr. Crowley Sr. is not an executive officer of Bank Mutual Corporation, his compensation as a Bank officer is reported in the section discussing executive compensation for ease of reference.

#### **SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE**

Under the federal securities laws, Bank Mutual Corporation's directors, its executive officers and any person holding more than 10% of the common stock are required to report their initial ownership of the common stock and any change in that ownership to the SEC. Specific due dates for these reports have been established and the Company is required to disclose in this proxy statement any failure to file such reports by these dates during the last year.

The Company believes that all of these filing requirements were satisfied on a timely basis for the year ended December 31, 2004. In making these disclosures, the Company has relied solely on written representations of its directors and executive officers and copies of the reports that they have filed with the SEC.

## EXECUTIVE COMPENSATION

### Summary Compensation Table

The following table sets forth information concerning the total compensation of the chief executive officer and the other four most highly compensated Company executive officers for services in all capacities for the last three fiscal years. The information includes service to, and payments by, the Company and its subsidiaries.

Information is also presented for Mr. Crowley Sr. who is an executive officer of the Bank, and was an executive officer of the MHC, the mutual holding company which controlled the Company until the October 2003 restructuring transaction, and was a director of the Company until December 31, 2004. He is not an executive officer of the Company itself and therefore is not required to be included in this table; however, his compensation is reported here, for ease of reference, as a consequence of his service as a Company director during 2004.

Name and Principal Positions	Year	Annual Compensation (1)		Long-Term Compensation Awards		
		Salary(\$)(2)	Bonus(\$)(3)	Restricted Stock Awards (\$)(4)	Securities Underlying Options (#)(5)	All Other Compensation (\$)(6)
Michael T. Crowley, Jr. Chairman, President and CEO of the Company; President and CEO of the Bank	2004	\$636,800	\$122,140	\$2,988,440	700,000	\$ 147,080
	2003	\$645,000	\$ 94,240	--	--	\$ 134,172
	2002	\$611,153	\$ 94,962	--	--	\$ 100,605
Eugene H. Maurer, Jr. Senior VP and Secretary of the Company; Senior VP and Secretary/Treasurer of the Bank	2004	\$164,250	\$ 28,547	\$ 426,920	100,000	\$ 42,571
	2003	\$158,250	\$ 21,649	--	--	\$ 36,174
	2002	\$153,297	\$ 21,033	--	--	\$ 26,795
P. Terry Anderegg Senior VP- Retail and Operations of the Bank	2004	\$164,250	\$ 27,955	\$ 426,920	100,000	\$ 42,376
	2003	\$158,250	\$ 21,649	--	--	\$ 35,318
	2002	\$149,395	\$ 21,649	--	--	\$ 26,092
Christopher J. Callen Senior VP-Lending of the Bank	2004	\$159,925	\$ 27,219	\$ 426,920	100,000	\$ 41,564
	2003	\$153,925	\$ 21,057	--	--	\$ 35,073
	2002	\$148,986	\$ 20,482	--	--	\$ 25,953
Rick B. Colberg Chief Financial Officer of the Company	2004	\$116,500	\$ 20,655	\$ 426,920	100,000	\$ 30,122
	2003	\$107,500	\$ 14,706	--	--	\$ 27,591
	2002	\$ 99,550	\$ 29,200	--	--	\$ 20,916
Michael T. Crowley, Sr. Chairman of the Bank (7)	2004	\$250,600	\$ 33,278	\$ 341,536	80,000	\$ 60,447
	2003	\$265,000	\$ 36,480	--	--	\$ 53,717
	2002	\$257,283	\$ 38,304	--	--	\$ 41,162

- (1) While each of the named individuals received perquisites or other personal benefits in the years shown, the value of these benefits is not specified, since they did not together exceed the lesser of \$50,000 or 10% of the individual's salary and bonus in any year. See "Perquisites and Other Benefits" below.
- (2) Includes any directors' fees paid to the individual.
- (3) Annual bonus amounts are earned and accrued during the years indicated and paid after the beginning of the next calendar year.
- (4) Represents grants of restricted shares under the management recognition plan provisions of the 2004 Plan. Shares vest over a five year period. The amounts represent the number of shares granted times the \$10.673 average market price on the date of grant.
- (5) Represents stock options granted under the 2004 Plan. No SARs have been granted thereunder.

- (6) In 2004, includes employer contributions to the 401(k) Plan in the following amounts: Mr. Crowley Jr.--\$1,658; Mr. Maurer--\$1,859; Mr. Anderegg--\$1,552; Mr. Callen--\$1,100; Mr. Colberg--\$1,312; and Mr. Crowley Sr.--\$1,842. Amounts also include the following 2004 ESOP allocations: Mr. Crowley Jr.--\$43,694; Mr. Maurer--\$40,712; Mr. Anderegg--\$40,824; Mr. Callen--\$39,754; Mr. Colberg--\$28,810; and Mr. Crowley Sr.--\$43,694. Also included in 2004 are the following Restoration Plan payments: Mr. Crowley Jr.--\$101,728; Mr. Callen--\$710; and Mr. Crowley Sr.--\$14,911.
- (7) Mr. Crowley Sr. is an executive officer of the Bank, but not of Bank Mutual Corporation. He was a director of Bank Mutual Corporation until December 31, 2004, when he retired from that position.

### Stock Options and Equity Compensation Plans

#### Option/SAR Grants in Last Fiscal Year

The following table sets forth information with respect to options granted to the five executive officers and one other person named in the Summary Compensation Table concerning options granted in fiscal 2004.

<u>Name</u>	<u>Securities Underlying Options/SARs Granted (#)(1)</u>	<u>Percent of Options/SARs Granted to Employees in Fiscal Year</u>	<u>Exercise or Base Price (\$/sh)</u>	<u>Expiration Date</u>	<u>Realized Value at Assumed Annual Rates of Stock Price Appreciation for Option Term (2)</u>	
					<u>5%</u>	<u>10%</u>
Michael T. Crowley, Jr.	700,000	40.2%	\$10.673	5/3/14	\$4,698,535	\$11,907,009
Eugene H. Maurer, Jr.	100,000	5.7	10.673	5/3/14	671,219	1,701,001
P. Terry Anderegg	100,000	5.7	10.673	5/3/14	671,219	1,701,001
Christopher J. Callen	100,000	5.7	10.673	5/3/14	671,219	1,701,001
Rick B. Colberg	100,000	5.7	10.673	5/3/14	671,219	1,701,001
Michael T. Crowley, Sr.	80,000	4.6	10.673	5/3/14	536,975	1,360,801

(1) No SARs have been granted; all grants reflect stock options under the 2004 Plan.

(2) Assumes the stated appreciation from the date of grant.

#### Aggregated Option/SAR Exercises in Last Fiscal Year and Fiscal Year End Options/SAR Values

The following table sets forth information with respect to the five executive officers and one other person named in the Summary Compensation Table concerning options exercised in 2004 and the number and value of options outstanding at December 31, 2004.

<u>Name</u>	<u>Shares Acquired on Exercise (#)</u>	<u>Value Realized (\$)(1)</u>	<u>Number of Securities Underlying Unexercised Options/SARs at FY-End (#)(2)</u>	<u>Value of Unexercised in the Money Options/SARs at FY-End (\$)(3)</u>
			<u>Unexercisable/Exercisable</u>	<u>Unexercisable/Exercisable</u>
Michael T. Crowley, Jr.	31,195	\$ 222,870	970,009 / 331,428	\$3,468,363 / \$2,791,771
Eugene H. Maurer, Jr.	---	---	166,035 / 99,051	741,659 / 887,938
P. Terry Anderegg	---	---	166,035 / 99,051	741,659 / 887,938
Christopher J. Callen	---	---	166,035 / 99,051	741,659 / 887,938
Rick B. Colberg	2,500	22,536	166,035 / 94,551	741,659 / 847,593
Michael T. Crowley, Sr.	157,725	1,281,981	226,744 / 0	1,435,232 / 0

(1) Represents the difference between the exercise price and the average of the high and low sales price on the date of exercise.

(2) Represents options granted under the 2001 or 2004 Plan. No SARs have been granted.

- (3) Represents the difference between the exercise price and the \$12.17 reported closing price of Company common stock on the Nasdaq Stock Market on December 31, 2004, the last trading date of the fiscal year.

### Defined Benefit Retirement Plans

The Company maintains a qualified defined benefit pension plan that covers substantially all employees who are age 21 or over and who have at least one year of service. Pension benefits are based on the participant's average annual compensation (salary and bonus) and years of credited service to the Company and the Bank. Years of credited service in the qualified defined benefit pension plan begin at date of participation in the plan. Benefits are determined in the form of a ten year certain and life annuity.

Designated officers also participate in a supplemental non-qualified defined benefit pension plan. This non-qualified plan provides monthly supplemental benefits to participants which will be paid out of the rabbi trust established for this plan, or unsecured corporate assets. The amount of the non-qualified plan benefit in the form of a ten year certain and life annuity is determined as:

- an amount calculated under the qualified defined benefit pension plan without regard to the limitations imposed by the Internal Revenue Code on benefit or compensation amounts and without regard to certain limitations on years of service; minus
- the pension benefit accrued in the qualified defined benefit pension plan.

The following table shows the estimated annual benefits payable in ten year certain and life annuity form for participants retiring on their normal retirement date at age 65 with various combinations of years of service and average annual compensation under the qualified defined benefit plan plus, for those officers eligible to participate, the non-qualified plan.

Final Average Compensation	Years of Service							
	5	10	15	20	25	30	35	40
\$ 100,000	\$ 9,100	\$ 18,100	\$ 27,200	\$ 36,200	\$ 47,800	\$ 59,300	\$ 70,900	\$ 81,000
150,000	14,300	28,600	42,800	57,100	75,200	93,200	111,200	126,300
200,000	19,500	39,000	58,500	78,000	102,500	127,000	151,600	171,700
250,000	24,700	49,500	74,200	98,900	129,900	160,900	191,900	217,000
300,000	30,000	59,900	89,900	119,800	157,300	194,700	232,200	262,400
350,000	35,200	70,400	105,500	140,700	184,700	228,600	272,500	307,700
400,000	40,400	80,800	121,200	161,600	212,000	262,400	312,900	353,100
450,000	45,600	91,300	136,900	182,500	239,400	296,300	353,200	398,400
500,000	50,900	101,700	152,600	203,400	266,800	330,100	393,500	443,800
550,000	56,100	112,200	168,200	224,300	294,200	364,000	433,800	489,100
600,000	61,300	122,600	183,900	245,200	321,500	397,800	474,200	534,500
650,000	66,500	133,100	199,600	266,100	348,900	431,700	514,500	579,800
700,000	71,800	143,500	215,300	287,000	376,300	465,500	554,800	625,200
750,000	77,000	154,000	230,900	307,900	403,700	499,400	595,100	670,500
800,000	82,200	164,400	246,600	328,800	431,000	533,200	635,500	715,900
850,000	87,400	174,900	262,300	349,700	458,400	567,100	675,800	761,200

Years of service in the non-qualified defined benefit pension plan begin at date of hire, except as discussed above. At March 31, 2005, accrued years of service for officers named in the summary compensation table were: Mr. Crowley Jr. - 37 years, Mr. Maurer - 22 years, Mr. Anderegg - 11 years, Mr. Callen - 5 years, and Mr. Colberg - 3 years. As of March 31, 2005, Mr. Crowley Sr. has more than 70 years of service with the Bank. The amount of his total annual accrued benefit as of December 31, 2004 was approximately \$401,700.

As discussed above, a portion of the benefits reported in the table are payable pursuant to the Company's supplemental non-qualified retirement plan for certain designated officers; currently, only Messrs. Crowley Jr. and Sr. are so designated. To support those obligations, the Company maintains assets in a "rabbi trust" (the amount of which is based on the actuarial value of future benefits) and expenses payments into the rabbi trust when they are made. These amounts will be paid from the Company's funds (including funds in the rabbi trust) in the future, and will not be paid out of assets in the qualified plan. Assuming that covered cash compensation remains constant through retirement at age 65, the approximate annual benefit discussed above which would be payable by the Company itself to Mr. Crowley Jr. would be \$465,444, and to Mr. Crowley Sr. would be \$295,724 under the supplemental plan.

### **Employment Arrangements**

The Bank has employment agreements with Messrs. Crowley Sr., Crowley Jr., Maurer, Anderegg, Callen and Colberg and Ms. Scholz (another executive officer). The initial terms of the employment agreements were three years. For each of Messrs. Crowley, each year the agreement may be extended so that the agreement remains in effect for a rolling three years upon agreement of Messrs. Crowley and by affirmative action of the Bank's board of directors. For the other executives, on each anniversary date thereafter, the employment term may be extended for an additional year upon agreement of the executive and by affirmative action taken by the Bank's board. The terms of each were so extended at January 1, 2005. Under the employment agreements, each executive is entitled to a base salary which is reviewed annually based upon individual performance and the Bank's financial results, as well as benefits and perquisites, in accordance with the Bank's policies.

The current annual salary amounts for each of the covered executive officers are as follows: Mr. Crowley Jr. - \$620,000; Mr. Maurer - \$170,250; Mr. Anderegg - \$171,250; Mr. Callen - \$170,000; Mr. Colberg - \$122,500; and Ms. Scholz - \$120,000. Mr. Crowley Sr.'s current salary amount is \$240,000. These amounts may be changed in subsequent years, but generally may not be reduced.

The employment agreements can be terminated at the election of the executive officer or the Bank at the expiration of the term, at any time for cause, upon the occurrence of certain events specified by federal statute or regulation, or as a result of the executive officer's retirement, disability or death. Each employment agreement can also be voluntarily terminated without cause by the executive officer or the Bank. Each executive officer may also terminate his or her employment agreement under certain circumstances following a change in control.

Upon each executive's death or retirement at age 65, the executive or the executive's personal representative will receive his or her earned but unpaid base salary and incentive compensation prorated to the end of the calendar month in which such termination occurs and compensation for accrued but unused vacation time. If the executive officer terminates employment voluntarily or is terminated by the Bank for cause, the executive shall not be entitled to any compensation or benefits for any period after the date of termination.

If during the term the Bank terminates an executive officer without cause or the employment agreement is terminated by the executive officer for cause, the executive would be entitled to receive 100% of base salary at the time of termination through the end of a one-year severance period. In the case of Messrs. Crowley, however, the period is extended to 12 months beyond the current term of employment, but not more than 36 months. Also, the executive would continue to receive certain insurance and other benefits until twelve months after the end of the term of employment. The Bank must also pay to each executive an additional lump sum cash payment in an amount equal to the product of the Bank's annual aggregate contributions for the executive to all qualified retirement plans in the year preceding termination and the number of years in the severance period.

Under each employment agreement, the executive officer may also terminate employment following a change in control of the Bank under certain circumstances, including a reduction in compensation or responsibilities. Upon any such termination as a result of a change in control, each executive officer has a right to receive payments and benefits as if a termination by the Bank without cause had occurred. However, the aggregate amount of all severance payments and termination benefits, computed on a present value basis, may not exceed an amount which would cause the payments to be characterized as parachute payments within the meaning of Section 280G(b)(2) of the Internal Revenue Code (the "Code"). That section generally defines parachute payments to include any



severance payments and termination benefits which, on a present value basis, equal or exceed three times the person's average annual total compensation over a five-year period immediately preceding the change in control.

### **Other Benefit Plans and Benefits**

*2001 and 2004 Stock Incentive Plans.* The Company maintains two stock incentive plans, under which equity-based awards may be made. The 2001 Plan was approved by shareholders in that year; no further grants may be made under the 2001 Plan since the Company's 2003 restructuring to a fully shareholder-owned company. As a consequence and to provide for ongoing equity-based incentives, in 2004 the shareholders approved the 2004 Plan as a successor plan.

Both the 2001 and 2004 Plans provide for the grant of stock options and shares of restricted stock to executive officers, directors and key employees of the Company and the Company's subsidiaries (including the Bank). Stock options may be either incentive stock options, up to the limits under law, or non-qualified stock options. All stock options must provide for an exercise price equal to the fair market value of the Company's common stock on the date of grant. The maximum option term under the 2001 and 2004 Plans is 10 years. Shares of restricted stock may also be granted under both plans; under the 2004 Plan, those grants may also be coupled with performance criteria in addition to time vesting. Pursuant to each of these plans and OTS regulations, no individual may receive more than 25% of the shares which can be issued under the 2001 Plan on the 2004 Plan, and non-employee directors as a group are limited to not more than 30% of the shares which can be issued under either plan, and individually to not more than 5%.

The Compensation Committee of the Board of Directors administers both the 2001 and 2004 Plans. The Committee makes determinations as to whom options and restricted stock grants are made and the number of shares. The options and grants vest 20% per year, becoming fully vested after five years, subject to accelerated vesting in the event of a change in control, death or disability, and the Committee's discretion under the 2001 Plan to waive conditions to exercise. The Committee also interprets the Plans and takes other related actions.

Information on awards made under the 2001 and 2004 Plans is set forth above in "Directors Compensation -2001 and 2004 Stock Incentive Plans" as to grants made to directors, and "Summary Compensation Table" and "Stock Options and Equity Compensation Plans" under "Executive Compensation" as to awards made to executive officers in the past three years.

*Employee Stock Ownership Plan.* The ESOP is a tax-qualified plan that covers substantially all salaried employees who have at least one year of service and have attained age 21. It became effective at the completion of the Bank's 2000 restructuring. The Company loaned the ESOP sufficient funds to purchase up to 8% of the Company shares issued in that transaction to persons other than the MHC. The ESOP has purchased 3,271,947 Company shares.

The loan is for a term of ten years and calls for level annual payments of principal. Interest payments, at the prime rate, will be made quarterly. The ESOP initially pledged the shares it purchased as collateral for the loan and holds them in a suspense account until allocated to employees upon repayment of loan principal.

The ESOP does not allocate the pledged shares immediately. Instead, it will release a portion of the pledged shares annually as payments are made on the loan. The loan payments made by the ESOP come from employer contributions and, in 2002, dividends paid on the shares held in the plan. If the ESOP repays its loan as scheduled over a 10-year term, 10% of the shares would be released and allocated to participants annually in 2001 through 2010. As a result of the actual payments made, 327,194, 327,194 and 436,960 shares were allocated to participants' accounts in 2004, 2003 and 2002, respectively. The ESOP allocates the shares released each year that are attributable to employer contributions among the accounts of participants in proportion to their compensation for the year. For example, if a participant's compensation for a year represents 1% of the total compensation of all participants for the year, the ESOP would allocate to that participant 1% of the shares released for the year attributable to employer contributions.

ESOP participants direct the voting of shares allocated to their individual accounts. Shares in the suspense account, which are those not yet allocated to individual accounts, are voted at the Company board's discretion.

*Restoration Plans.* The Company also maintains "Restoration Plans" to compensate participants for any benefits under the ESOP and the Bank Mutual Corporation 401(k) Plan which they are unable to receive because of limitations under the Code on contributions and benefits. The plans were originally established in 2001 by the Bank as parts of a single plan; they were approved by the Compensation Committee as part of the assumption of the plans at the holding company level.

The Code limits the salary deferrals that an employee may contribute to the 401(k) Plan and also restricts the amount of tax-qualified plan benefits that can be received by plan participants.

The restoration plans provide benefits for officers and employees based upon the allocations they would have received in the ESOP in the absence of Code limitations. The restoration plans also permit eligible officers to defer compensation which they are unable to contribute to the 401(k) Plan and receive allocations thereunder because of Code limits. Under the Code, in 2004, only the first \$205,000 of compensation may be considered in determining benefits under tax-qualified plans. That amount is subject to annual cost-of-living adjustments, and increases to \$210,000 in 2005.

For example, under the ESOP, only the first \$205,000 of earnings are considered in determining ESOP benefits for 2004. Under the restoration plans, an executive officer or employee would receive an amount equal to the benefit that the participant would have received under the ESOP in the absence of the compensation limit. Therefore, if an officer had total compensation of \$300,000, the officer would receive an award equal to the average allocation percentage under the ESOP for the \$95,000 of compensation in excess of the Code limit.

The restoration plan relating to the ESOP covers all employees, and the plan relating to the 401(k) plan covers all executive officers. The annual allocations to employees under the restoration plans are not tax deductible by the employer or included in the taxable compensation of the employees receiving the allocations. When benefits are paid to employees following their termination of employment, the payments will be deductible by the employer and included in the taxable compensation of the employees receiving those payments.

*First Northern Supplemental Retirement Agreements.* Before it was acquired by the Company, First Northern Savings entered into a supplemental retirement agreement with Mr. Colberg and certain other officers. Under his agreement, Mr. Colberg, or his beneficiaries, will receive a total of 180 monthly payments of \$2,646 per month, respectively, commencing on the first day of the month following the earlier of his respective attainment of age 65 or his death. If the supplemental retirement benefits commence prior to the executive's attainment of age 65 because of his death, or if the executive officer requests acceleration of his benefit payments (and the Compensation Committee consents to such acceleration), the amount of the monthly payment will be reduced to reflect a 6% discount rate compounded monthly. These supplemental retirement agreements are vested and are subject to the same parachute payment limitations that govern employment agreements.

*Perquisites and Other Benefits.* Certain executive officers also received in 2004 use of a business automobile, and (in Mr. Colberg's case, as a consequence of former First Northern practices), tax preparation assistance as other benefits, which were not on the same terms as other salaried employees. The total value of these other benefits which were not on the same terms as other salaried employees did not exceed the lesser of \$50,000 or 10% of any individual's salary or bonus in any reported year. The value of such perquisites in 2004 was as follows: Mr. Crowley Jr. -- \$346; Mr. Colberg -- \$2,643; and Mr. Crowley Sr. -- \$4,925.

Executive officers qualify for the same group health, life and disability insurance benefits as other full-time salaried employees of the Company and its subsidiaries. In addition, the Company reimburses officers and other high-level employees for approved memberships in certain civic and industry groups, appropriate attendance at related functions and, in one case, the cost of a club membership used exclusively for appropriate business entertaining; however, because these expenses are reimbursed only if and to the extent they are for business purposes, these are not considered by the Company to be "perquisites" or personal benefits to these persons.

## COMPENSATION COMMITTEE REPORT ON EXECUTIVE COMPENSATION

*Committee Composition.* The Bank Mutual Corporation board of directors has established a Compensation Committee to determine salaries, and make other compensation and plan decisions. It made compensation determinations for 2004, and expects to continue in that role going forward. The current members of the Compensation Committee are identified below.

*Compensation Philosophy.* In determining compensation, the Committee has recognized that the Company and its subsidiaries must provide its executive officers and key employees a competitive compensation package in order to attract and retain talented and highly experienced personnel. The Committee has sought to offer compensation which it believes is in line with compensation paid by other similarly situated institutions (including banks, savings banks and savings associations, but not co-extensive with the broad based, nationwide group used for peer group comparison in the Performance Graph), so as to be neither unduly generous nor lagging other institutions. In making its decisions, the Committee has also noted that, as a mutual institution, the Bank previously could not provide stock-based incentive compensation, as could publicly held institutions, and noted the effect on prior compensation when going forward.

*Base Salary.* In determining the base salary of executive officers under their employment agreements, the Committee reviewed, among other things, third party surveys of peer institutions, the historical compensation of those officers and performance of the Company and its subsidiaries. The Committee noted that historical comparisons have been affected by the Company's formation of a mutual holding company and acquisition of First Northern in 2000, changes in accounting rules in 2001 affecting the amortization of goodwill, and the Company's full conversion transaction in 2003.

In making those performance reviews for fiscal 2004 compensation, the Committee also recognized the significant efforts which all of the executive officers made during 2003 to successfully complete the merger of First Northern into the Bank and the conversion of the Company into a fully shareholder-owned organization. The 2003 conversion transaction included a stock offering in which the Company received net proceeds of over \$400 million, substantially strengthening the Company's capital position. Base salary determinations were not directly related to statistical corporate performance, since the bonus and incentive plans are heavily performance based and remained significant in 2004. Based upon those factors, the Committee determined that executive officers (other than the CEO, whose base salary remained constant) should receive an increase (from 4% to 6%) in base salary, with amounts varying depending upon their individual responsibilities. The Committee also noted that stock-based incentives were awarded in 2001 and provided an additional means of compensation, but that no additional awards were made in 2002 or 2003; however, the Committee also noted that the 2004 Plan was proposed for shareholder approval and expected that, if the 2004 Plan were approved, equity-based awards would be made to executive officers during fiscal 2004.

*Bonus/Incentives.* For fiscal 2004, cash incentive payments were determined under the Bank's cash incentive plan. Under the plan for 2004, the Committee set the Company's return on assets and income targets, of 0.96% and \$29.3 million, respectively, as well as target bonus payments (expressed as a percentage of base salary) for each of the executive officers. Actual bonus amounts are determined based upon the Company's performance as to those financial criteria. For each average percentage point by which the Company missed its targets, the potential bonus would be reduced by 1.5 percentage points. The plan permits a portion of the bonus to be determined based on individual performance goals; that alternative was used for 20% of the bonus for selected individuals (excluding Messrs. Crowley) in 2004.

In fiscal 2004, the Company achieved 96.5% and 101.0% of its return on assets and income targets, respectively, for an average of 99%. Therefore, due to the reduction by 1.5 times the percent by which goals were missed, executive officers earned bonuses equaling 98.5% of their target bonus amounts, to the extent bonuses were determined by corporate performance. In cases in which an individual-based performance component was also paid to certain executive officers, it was also set at 98.5% of the target amount to mirror the statistical determination.

*Stock-Based Incentives.* The Committee believes that stock-based compensation can provide an important incentive to executive officers that also aligns their interests with those of shareholders, since the value of the compensation will depend upon the performance of the stock price. The ESOP has been established, and the 2001

and 2004 Plans were approved by shareholders, to provide certain stock-based compensation. However, Office of Thrift Supervision ("OTS") regulations limited the amount and types of stock-based compensation which could be authorized or granted within one year of Bank Mutual Corporation's initial restructuring and its 2003 conversion to a fully shareholder-owned corporation.

In view of the awards under the 2001 Plan made during 2001, the OTS regulations which limited the size of the 2001 Plan and the desire to retain the ability to grant additional options or awards to newly hired persons, the Committee did not grant any stock options, or award any restricted shares, to executive officers in 2002 or 2003. However, the Committee approved the 2004 Incentive Plan, subject to shareholder approval, to provide a continuing stock-based incentive to executive officers, key employees and directors. The 2004 Plan was approved by shareholders at the 2004 Annual Meeting.

Since no awards had been made during 2002 and 2003, the Committee determined that it would promptly make awards under the 2004 Plan. The Committee believed that the strong efforts of executive officers and other key employees created substantial value for shareholders during 2003 as a result of the successful completion of the conversion transaction and stock offering discussed above. To recognize these achievements, the fact that awards had not been made in the two prior years, strong corporate results and to provide significant equity-based incentive going forward, in 2004 the Committee made significant awards under the 2004 Plan. The awards to the CEO are discussed below; the Committee granted to each other executive officer options to purchase 100,000, and restricted stock award of 40,000 shares, which vest over a five-year period. The Committee determined generally to somewhat reduce the awards in 2004 as compared to those in 2001, in significant part because a larger portion of the available awards were not immediately granted and held available for the future.

*Chief Executive Officer Compensation.* In addition to the factors discussed above, when determining the salary of the Chief Executive Officer, the Committee continued a transition that began in 2002 to more incentive-based compensation but also to recognize in his base pay the high degree of satisfaction with his performance. The Committee noted the CEO's accomplishments during 2003, particularly the combining the two bank subsidiaries and the Company's successful full conversion transaction. The Committee therefore decided to keep constant the Chief Executive Officer's base salary in 2004. The Committee also noted that under the cash incentive plan, the Chief Executive Officer would be eligible to earn a target cash incentive bonus of up to 20% (and a maximum of 40%) of his \$620,000 base salary. His actual 2004 bonus was \$122,140, which in the CEO's case was 98.5% of the target bonus amount, determined solely as a result of corporate performance under the Bank's cash incentive plan. The CEO also receives board fees for service on the Bank's board of directors.

In addition, the Committee noted that the CEO would be eligible for stock-based compensation under the 2004 Plan, assuming approval by shareholders later in the year. No equity awards had been made in 2002 or 2003 as a result of the significant awards in 2001 and the limitation of shares available under the 2001 Plan. In view of the strong individual performance of the CEO and the Committee's determination to provide a substantial award which would have the opportunity of vesting in the ordinary course before Mr. Crowley Jr. would turn 68, the CEO received an award of 280,000 restricted shares and options to purchase 700,000 shares of common stock under the 2004 Plan, after it was approved by shareholders. These awards vest over a five year period, and are intended to both reward prior successes and service, and to incent the CEO on a going forward basis. The Committee determined to grant the CEO awards which were at or somewhat below the percentage of total available awards which were granted to him in 2001 under the 2001 Plan. The Committee also noted the reasons discussed above under "Stock-Based Incentives" for grants to all executive officers.

In 2004, the CEO was allocated 3,590 shares under the ESOP, on the same basis as other employees. The Committee also considered the CEO's participation in the Benefits Restoration Plan and his supplemental retirement benefits. Under the benefits restoration plan, the CEO received payments totaling \$101,728, due to the limitation of benefits under qualified plans relating to the 401(k) Plan and ESOP. The Committee continues to believe it is appropriate to maintain the benefits restoration plan and the supplemental retirement plan to fully recognize the CEO's compensation when determining benefits under other plans which generally are available to all full-time employees.

*Section 162(m) Limitations.* Section 162(m) of the Code limits the deductibility of compensation to certain executive officers of publicly held companies of over \$1 million in any fiscal year. Exceptions are made for, among

other things, performance-based plans approved by shareholders. Stock options are considered performance based compensation, although restricted stock awards are not unless they are coupled with performance goals. The Committee is mindful of these limitations; for 2004, approximately \$409,630 of Mr. Crowley Jr.'s taxable compensation (which resulted primarily from the vesting of restricted stock) was not deductible. Shareholder approval of the 2001 Plan and 2004 Plan was obtained, among other reasons to qualify for an exception from Section 162(m) for any performance-based compensation payable under the plans.

**Members of the Compensation Committee:**

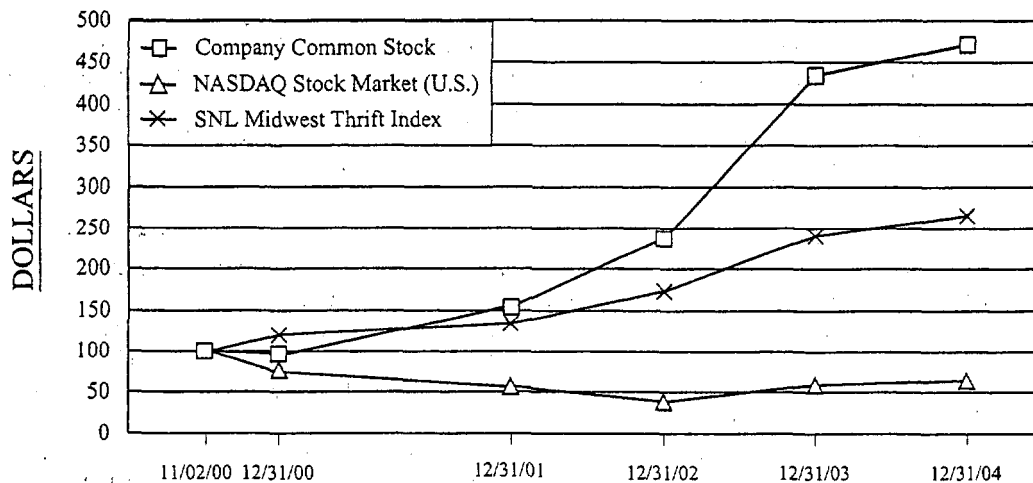
David J. Rolfs (Chairman)   Raymond W. Dwyer, Jr.   Thomas J. Lopina, Sr.   William J. Mielke

**COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION**

None of the members of the Compensation Committee was an officer or employee of the Company or a bank subsidiary, nor did any of them have any other reportable interlock. During 2004, Mr. Lopina had outstanding loans from the Bank; these loans were repaid in 2004. For a description of the Company's policies with respect to loans to officers, directors and employees, and Mr. Lopina's loans, see "Certain Transactions with the Company."

**PERFORMANCE GRAPH**

Set forth below is a line graph comparing the cumulative total shareholder return on Company common stock, based on the market price of the common stock and assuming reinvestment of cash dividends, with the cumulative total return of companies on the NASDAQ Stock Market US Index, and the SNL Midwest Thrift Index. The graph assumes \$100 was invested on November 2, 2000, the first date of our stock trading, in Company common stock and each of those indices.



Stock/Index	Period Ended					
	11/02/00	12/31/00	12/31/01	12/31/02	12/31/03	12/31/04
Company Common Stock	100.00	93.83	153.95	237.15	434.30	471.57
NASDAQ Stock Market (U.S.)	100.00	71.67	56.75	39.02	58.83	64.22
SNL Midwest Thrift Index	100.00	116.79	134.31	173.15	240.55	265.64

## CERTAIN TRANSACTIONS WITH THE COMPANY

### *Banking Relationships*

The Bank has had, and expects to continue to have, regular business dealings with its officers and directors, as well as their associates and the firms which they serve. The Bank's historical policy has been that transactions with its directors and executive officers be on terms that are no more beneficial to the director or executive officer than the Bank would provide to unaffiliated third parties. Directors and executive officers, and their associates, regularly deposit funds with the Bank; the deposits are made on the same terms and conditions which are offered to other depositors.

The Bank historically discouraged lending from the Bank to its insiders, but loans were occasionally made. Certain directors and executive officers have been indebted to the Bank for loans made in the ordinary course of business. Those loans have been on substantially the same terms, including interest rates and collateral, as those then prevailing for comparable transactions with other persons. These loans do not involve more than the normal risk of collectability or present other unfavorable features.

Upon the merger of First Northern into the Bank, the combined Bank adopted policies for loans, with preferential rates, to officers, directors and employees similar to First Northern's historical policies. Prior to its acquisition by the Company, First Northern established policies relating to loans to directors and officers which, consistent with applicable laws and regulations, permitted certain preferential loan terms to directors and executive officers. As a matter of practice, however, the Company continues to discourage such loans with its directors and executive officers. Management believes that the loans made to directors and officers do not involve more than the normal risk of collectability or present other unfavorable features.

The following table sets forth certain data relating to existing loans with these special terms to directors and executive officers of Bank Mutual Corporation where the aggregate amount of such loans exceeded \$60,000 at any time since January 1, 2004 and the interest rate was below that offered to all other customers for comparable transactions. Except as indicated, information for loans with no preferential terms is not, and need not be, presented.

<u>Name and Positions</u>	<u>Type</u>	<u>Date of Loan</u>	<u>Original Amount of Loan</u>	<u>Maximum Balance in 2004</u>	<u>Balance as of 12/31/04</u>	<u>Interest Rate During Last Fiscal Year</u>	<u>Comparable Note Rate for Other Customers</u>
Thomas J. Lopina, Sr. Director	Mortgage	6/23/93	\$110,000	\$ 50,228	\$ -0-	2.75%(4)	4.875%(4)
	LC (2)	12/11/00	\$65,000(2)	\$ 63,849	\$ -0-	4.5%(3)	5.5%(3)
Robert B. Olson Director	Mortgage	7/31/97	\$160,000	\$ 97,152	\$ -0-	2.75%(4)	6.625%(4)
J. Gus Swoboda Director	Mortgage (5)	4/13/98	\$170,000	\$126,322	\$117,093	2.75%(1)	5.125%

- (1) On January 1, 2005, in accordance with the First Northern mortgage loan policy for directors, officers and employees, the interest rate on mortgage loans for officers and directors was 2.75%, which was the interest rate since February 1, 2004. The rate was 3.0% in January 2004.
- (2) Line of credit. The amount shown for the original amount is the maximum amount which could have been borrowed under the line. The line was secured by a second mortgage.
- (3) The line of credit interest rate was based on the prime interest rate, and varied from 4.00% to 4.5% during the time the loan was outstanding in 2004; non-preferential rates varied from 5.5% to 6.0% during that period.
- (4) Loan paid off in 2004; rates shown at time of repayment.
- (5) During 2004, Mr. Swoboda also maintained a \$95,000 line of credit on non-preferential terms. The maximum amount outstanding during 2004 was \$89,014. The line of credit was fully repaid in 2004.

### *Architectural Fees*

Mr. Herr is partner in Plunkett Raysich Architects LLC, an architectural firm that from time to time provides architectural design and related services to the Bank. These types of fees tend to increase during periods in which the Bank is making arrangements to open or relocate multiple offices, such as was the case in 2004. For services during 2004, the Bank has paid Plunkett Raysich and its affiliates approximately \$113,150 for such services. During 2003 and 2002, fees payable to that firm were less than \$60,000 in each year.

### **REPORT OF THE AUDIT COMMITTEE**

The Audit Committee of the Bank Mutual Corporation board of directors was constituted in 2000, upon the Company's formation. The Audit Committee's functions include meeting with the Company's independent auditors and making recommendations to the board regarding independent public accountants; assessing the adequacy of internal controls, accounting methods and procedures; review of public disclosures required for compliance with securities laws; and consideration and review of various other matters relating to the Company's financial accounting and reporting. No member of the Audit Committee is employed by or has any other material relationship with the Company. The members are "independent" as defined in Rule 4200(a)(15) of the NASD listing standards for the Nasdaq Stock Market. The board of directors has adopted a written charter for the Audit Committee; a copy of that charter was attached to the 2004 annual meeting proxy statement and is available on the Company's website.

In connection with its function to oversee and monitor the financial reporting process of the Company, the Audit Committee has done the following:

- reviewed and discussed the audited financial statements for the fiscal year ended December 31, 2004 with Bank Mutual Corporation management;
- discussed with Ernst & Young LLP, the Company's independent auditors, those matters which are required to be discussed by SAS 61 (Codification of Statements on Auditing Standards, AU §380); and
- received the written disclosures and the letter from Ernst & Young LLP required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees) and has discussed with Ernst & Young LLP its independence.

Based on the foregoing, the Audit Committee recommended to the board that those audited financial statements be included in the Company's annual report on Form 10-K for the year ended December 31, 2004.

In addition, the Audit Committee also considered the fees paid to Ernst & Young LLP for services provided by Ernst & Young during 2004. See "Independent Auditors" below. The Committee believes that the provision of the non-audit services is compatible with maintaining Ernst & Young's independence.

Members of the Audit Committee:

William J. Mielke, Chairman      Thomas H. Buestrin      Robert B. Olson      David J. Rolfs

### **INDEPENDENT AUDITORS**

The firm of Ernst & Young LLP has audited the books and records of Bank Mutual Corporation for 2004; it has served as the independent accountants for the Bank for more than 20 years and of the Company since its inception in 2000. The audit committee and board of directors have decided to appoint Ernst & Young LLP as the independent auditors to audit the books and accounts of the Company for 2005, subject to shareholder ratification. Representatives of Ernst & Young LLP are expected to be present at the annual meeting to respond to appropriate questions and to make a statement if they so desire.

Fees (including reimbursements for out-of-pocket expenses) paid to Ernst & Young LLP for services relating to fiscal 2004 and 2003 were as follows:

	<u>2004</u>	<u>2003</u>
Audit fees:	\$ 295,000	\$ 270,000
Audit-related fees:	-0-	-0-
Tax fees:	52,525	40,475
All other fees:	-0-	-0-

The above amounts relate to services provided in the indicated fiscal years, irrespective of when they were billed. Audit fees in 2003 included professional services related to the audited financial statements in connection with Bank Mutual Corporation's SEC registration statement for its 2003 offering of stock. Tax services consisted solely of compliance matters, including tax return assistance. The Audit Committee considered the compatibility of non-audit services by Ernst & Young LLP with the maintenance of that firm's independence.

The Audit Committee generally approves all engagements of the independent auditor in advance, including approval of the related fees. The Audit Committee approves individual projects and the approved levels of fees for each. Management must have them approved by the Committee. Projects of the types approved in general by the Committee for which fees total less than \$10,000 in each case may be approved by management with the concurrence of the chair of the audit committee, subject to review and approval by the Committee at its next meeting. There were no services or fees in 2004 or 2003 that were not approved in advance by the Committee or by the chairman under this policy.

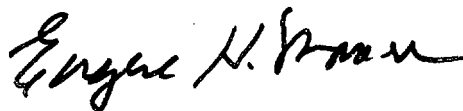
#### SHAREHOLDER PROPOSALS AND NOTICES

Shareholder proposals must be received by the Secretary of Bank Mutual Corporation, Eugene H. Maurer, Jr., no later than November 18, 2005 in order to be considered for inclusion in next year's annual meeting proxy materials pursuant to the SEC's Rule 14a-8 under the Securities Exchange Act.

Under SEC rules relating to the discretionary voting of proxies at shareholder meetings, if a proponent of a matter for shareholder consideration (other than a shareholder proposal) fails to notify Bank Mutual Corporation at least 45 days prior to the month and day of mailing the prior year's proxy statement, then management proxies are allowed to use their discretionary voting authority if a proposal is raised at the annual meeting, without any discussion of the matter in the proxy statement. Therefore, any such matters must be received by the Company by February 1, 2006 in the case of the 2006 annual meeting of shareholders. The Company is not aware of any such proposals for the 2005 annual meeting.

The Company's bylaws also require that any nomination of a director or submission of a matter for consideration of the meeting must be presented, with specified accompanying information, to Bank Mutual Corporation's corporate Secretary at least 70, but not more than 100, days before the scheduled date for the next annual meeting of shareholders. No such submissions have been received by the Company for the 2005 annual meeting. Assuming that the 2006 annual meeting is held as scheduled on May 1, 2006, the period in which materials must be received is between January 20, 2006 and February 19, 2006 for the 2006 annual meeting.

By Order of the Board of Directors



Eugene H. Maurer, Jr.  
Senior Vice President and Secretary

Milwaukee, Wisconsin  
March 11, 2005



A copy (without exhibits) of Bank Mutual Corporation's Annual Report on Form 10-K filed with the SEC for the year ended December 31, 2004 is attached to this proxy statement. The Company will provide an additional copy of the 10-K (without exhibits) without charge to any record or beneficial owner of Company common stock on the written request of that person directed to: Rick B. Colberg, Chief Financial Officer, Bank Mutual Corporation, 4949 West Brown Deer Road, Milwaukee, Wisconsin 53223. The 10-K provides a list of exhibits, which will be provided for a reasonable fee to reflect duplication and mailing costs; exhibits are also available through the SEC's website at [www.sec.gov](http://www.sec.gov).

***Multiple Shareholders Sharing the Same Address.*** In some cases, we have multiple shareholders of record at a single address. We are sending a single annual report and proxy statement to that address unless we received instructions to the contrary. Each shareholder of record, however, will continue to receive a separate proxy card. This practice, known as "householding," is designed to reduce our printing and postage costs. If you wish to receive separate copies of the annual report and proxy statement now or in the future, or to discontinue householding entirely, you may call our transfer agent, Registrar and Transfer Company, at 1-800-368-5948, contact it by e-mail at [info@rtco.com](mailto:info@rtco.com), or provide written instructions to Registrar and Transfer Company, 10 Commerce Drive, Cranford, New Jersey 07016-3572.

If you receive multiple copies of the annual report and proxy statement, you also may contact our transfer agent at the telephone number or address above to request householding. If your shares are held in street name through a bank, broker or other holder of record, you may request householding by contacting that bank, broker or other holder of record.

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2004

Commission file number: 000-31207

**BANK MUTUAL CORPORATION**

(Exact name of registrant as specified in its charter)

Wisconsin  
(State or other jurisdiction of  
incorporation or organization)

39-2004336  
(I.R.S. Employer Identification No.)

4949 West Brown Deer Road, Milwaukee, WI  
(Address of principal executive offices)

53223  
(Zip Code)

Registrant's telephone number, including area code: (414) 354-1500

Securities registered pursuant to Section 12(b) of the Act:

NONE

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, \$0.01 Par Value  
(Title of class)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No       

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

Indicate by check mark whether the registrant is an accelerated filer (as defined in rule 12b-2 under the Exchange Act).

Yes X No       

As of February 28, 2005, 68,964,713 shares of Common Stock were validly issued and outstanding. The aggregate market value of the Common Stock (based upon the \$10.90 last sale price quotation on The Nasdaq Stock Market® on June 30, 2004, the end of our second fiscal quarter) held by non-affiliates (excluding shares reported as beneficially owned by directors and executive officers and unallocated shares of the Employee Stock Ownership Plan; does not constitute an admission as to affiliate status) was approximately \$694.0 million.

**DOCUMENTS INCORPORATED BY REFERENCE**

**Document**

**Part of Form 10-K Into Which  
Portions of Document are Incorporated**

Proxy Statement for Annual Meeting of  
Shareholders on May 2, 2005

Part III

**BANK MUTUAL CORPORATION**  
**FORM 10-K ANNUAL REPORT TO THE SECURITIES AND EXCHANGE COMMISSION**  
**FOR THE YEAR ENDED DECEMBER 31, 2004**

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## **Part 1**

### **Item 1. Business**

#### **General**

From November 1, 2000 until October 29, 2003, Bank Mutual Corporation was an OTS chartered United States corporation which became the mid-tier holding company in the regulatory restructuring of Mutual Savings Bank, into mutual holding company form. Until October 29, 2003, Bank Mutual Bancorp, MHC (the "MHC"), a U.S.-chartered mutual holding company of which Mutual Savings Bank's depositors held all of the voting and membership rights, owned a majority of Bank Mutual Corporation's outstanding common stock.

On November 1, 2000, Bank Mutual Corporation acquired First Northern Capital Corp., the parent of First Northern Savings Bank. On March 16, 2003, Mutual Savings Bank and First Northern Savings Bank combined to form a single OTS chartered savings bank subsidiary of Bank Mutual Corporation named "Bank Mutual" ("Bank Mutual" or the "Bank").

On October 29, 2003, Bank Mutual Corporation completed a conversion and reorganization from a mutual holding company form, established a new Wisconsin chartered Bank Mutual Corporation and, in effect, sold the MHC's interest in Bank Mutual Corporation to the public. Existing Bank Mutual Corporation shareholders exchanged each existing share for 3.6686 shares of the new Bank Mutual Corporation (the "Company"). The total number of shares issued or exchanged in the offering was 78,707,669 shares.

All share and per share numbers in this report on form 10-K have been adjusted to reflect the full conversion transaction and related share exchange. As used herein, the "Company" and "Bank Mutual Corporation" refer to Bank Mutual Corporation both before and after the full conversion transaction, unless the context requires otherwise.

The Bank is a community oriented financial institution, which emphasizes traditional financial services to individuals and businesses within our market areas. Our principal business is originating mortgage loans, consumer loans, commercial real estate loans, and commercial business loans and attracting retail deposits from the general public. We also invest in various mortgage-related securities and investment securities. The principal lending is on one-to four-family, owner-occupied homes, home equity loans and lines of credit, automobile loans, multi-family and commercial real estate loans, and commercial business loans.

The Bank's revenues are derived principally from interest on our loans and mortgage-related securities, interest and dividends on our investment securities, and noninterest income (including loan servicing fees, deposit servicing fees, gains on sales of loans and commissions on insurance, security and annuity sales). Our primary sources of funds are deposits, borrowings, scheduled amortization and prepayments of loan principal and mortgage-related securities, and maturities of investment securities and funds provided by operations.

The Company maintains a website at [bankmutualcorp.com](http://bankmutualcorp.com). We make available through that website, free of charge, copies of our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports, as soon as reasonably practical after the Company electronically files those materials with, or furnishes them to, the Securities and Exchange Commission. You may access those reports by following the links under "Financial Reports" at the Company's website.

#### **Cautionary Factors**

This Form 10-K contains or incorporates by reference various forward-looking statements concerning the Bank's prospects that are based on the current expectations and beliefs of management. Forward-looking statements may also be made by the Company from time to time in other reports and documents as well as oral presentations. When used in written documents or oral statements, the words "anticipate," "believe," "estimate," "expect," "objective" and similar expressions and verbs in the future tense, are intended to identify forward-looking statements. The statements contained herein and such future statements involve or may involve certain assumptions, risks and

uncertainties, many of which are beyond the Company's control, that could cause the Bank's actual results and performance to differ materially from what is expected. In addition to the assumptions and other factors referenced specifically in connection with such statements, the following factors could impact the business and financial prospects of the Company: general economic conditions; legislative and regulatory initiatives; increased competition and other effects of the deregulation and consolidation of the financial services industry; monetary and fiscal policies of the federal government; deposit flows; disintermediation; the cost of funds; general market rates of interest; interest rates or investment returns on competing investments; demand for loan products; demand for financial services; changes in accounting policies or guidelines; general economic developments; acts of terrorism and developments in the war on terrorism; and changes in the quality or composition of loan and investment portfolios. See also the factors regarding future operations discussed in "Management's Discussion and Analysis of Financial Condition and Results of Operations" below, particularly those under the caption "Risk Factors."

### **Market Area**

At February 25, 2005, the Bank has 70 banking offices located in 28 counties in Wisconsin, in addition to a Minnesota bank office. At June 30, 2004, The Bank had approximately a 2.32% share of all Wisconsin bank, savings bank, and savings association deposits. Counties in which the Bank operates include 67% of the population of the state. The Bank is the fourth largest financial institution holding company headquartered in the state of Wisconsin, based on asset size.

The largest concentration of our offices is in the Milwaukee metropolitan area, which includes Milwaukee, Waukesha, Racine, Ozaukee, and Washington counties. There are 19 offices in this area, and we are opening a 20<sup>th</sup> office in spring 2005. The Milwaukee metro area is the largest population and commercial base in Wisconsin, representing approximately 28% of Wisconsin's population. The Milwaukee area has traditionally had an extensive manufacturing economic base, which is diversifying into service and technology based businesses.

We have four offices in the Madison area. Madison is the state capital of Wisconsin and is the second largest metropolitan area in Wisconsin representing approximately 8% of the state's population. Our eight other south central and southeastern Wisconsin offices are located in smaller cities that have economic concentrations ranging from manufacturing to agriculture.

We operate 21 banking offices in nine northeastern counties that make up approximately 16% of the state's population including the city of Green Bay. The greater Green Bay area has an economic base of paper and other manufacturing, health care, insurance and gaming, and is diversifying into technology based businesses. Two of our offices in this region are near the Michigan border; we are also developing customers in northern Michigan.

We also have 19 offices in the northwestern part of the state. This part of the state has medium sized to smaller cities and towns. Industry includes medium sized and small business, with a significant agricultural component. The counties in which the northwest region offices are located hold 8% of the state's population. Our Minnesota office is located near the Wisconsin state border on the eastern edge of the Minneapolis-St. Paul metropolitan area.

### **Competition**

We face significant competition in making loans and attracting deposits. Wisconsin has many banks, savings banks, and savings and loan associations, which offer the same types of banking products as the Company. Wisconsin also has an extensive tax-exempt credit union industry, whose expanded powers have resulted in increased competition to financial institutions.

Many of our competitors have greater resources than we do. Similarly, many competitors offer services that we do not provide. For example, the Bank does not provide trust or money management services. However, the Bank's subsidiary, Lake Financial and Insurance Services, Inc. offers mutual funds and engages in the sale of tax deferred annuities, credit life and disability insurance, and property and casualty insurance and brokerage services. In addition, the banking business in the Milwaukee area, our largest market, tends to be dominated by the two largest commercial banks in the state, which together held 51.44% of the Milwaukee area's deposits at June 30, 2004.

Most of our competition for loans traditionally has come from commercial banks, savings banks, savings and loan associations and credit unions. Increasingly, other types of companies, such as mortgage banking firms, finance companies, insurance companies, and other providers of financial services also compete for these products. For deposits, we also compete with traditional financial institutions. However, competition for deposits now also includes mutual funds, particularly short-term money market funds, and brokerage firms and insurance companies. The recent increase in electronic commerce also increases competition from institutions and other entities outside of Wisconsin.

### **Lending Activities**

*Loan Portfolio Composition.* The Company's loan portfolio primarily consists of mortgage loans. To a lesser degree, the loan portfolio includes consumer loans, including home equity lines of credit and fixed and adjustable rate home equity loans, automobile loans, as well as commercial business loans.

At December 31, 2004, our total loans receivable was \$1.9 billion, of which \$1.4 billion, or 71.9%, consisted of one to four family (\$903.5 million or 46.3%) and other mortgage loans (\$498.7 million or 25.6%). The remainder of our loans at December 31, 2004, amounting to \$547.4 million, or 28.1% of total loans, consisted of consumer loans (\$477.3 million or 24.5%) and commercial business loans (\$70.2 million or 3.6%).

We originate adjustable rate mortgage ("ARM") loans primarily for our own portfolio. We also originate fixed rate mortgage loans with terms of 10 to 30 years. Most of the 20 year and longer fixed rate mortgage loans are immediately sold into the secondary market. At times, we may also sell 15 year fixed rate mortgage loans depending on the percentage of fixed interest rate loans in our portfolio and our tolerance for fixed interest rates in view of the interest rate environment we are anticipating. We sold approximately \$5.8 million of our 15 year fixed rate mortgage loan originations in 2004.

The loans that we originate and purchase are subject to federal and state laws and regulations. The interest rates we charge on loans are affected principally by the demand for loans, the cost and supply of money available for lending purposes and the interest rates offered by our competitors. These factors are in turn affected by, among other things, economic conditions, monetary policies of the federal government, including the Federal Reserve Board, legislative tax policies and governmental budgetary matters.

The following table presents the composition of our loan portfolio in dollar amounts and in percentages of the total portfolio at the dates indicated.

At December 31,

	2004			2003			2002			2001			2000		
	Percent Of			Percent Of			Percent Of			Percent Of			Percent Of		
	Amount	Total	Amount	Amount	Total	Amount	Amount	Total	Amount	Amount	Total	Amount	Amount	Total	
	(Dollars in thousands)														
Mortgage loans:															
One- to four-family	\$ 903,498	46.34%	\$ 793,247		44.69%	\$ 827,648		47.37%	\$ 992,126		52.46%	\$ 1,207,912		59.56%	
Multi-family	161,641	8.29	124,494		7.01	112,189		6.42	131,925		6.97	105,925		5.22	
Commercial real estate	195,708	10.04	209,293		11.79	186,960		10.70	165,556		8.75	118,636		5.85	
Construction and development	141,394	7.25	122,436		6.90	127,174		7.28	125,611		6.64	94,235		4.65	
Total mortgage loans	1,402,241	71.92	1,249,470		70.39	1,253,971		71.77	1,415,218		74.82	1,526,708		75.28	
Consumer loans:															
Fixed-term equity	266,635	13.67	252,550		14.22	234,049		13.40	200,500		10.61	193,394		9.54	
Home equity lines of credit	88,444	4.54	78,567		4.43	77,697		4.45	76,472		4.04	80,447		3.97	
Student	20,519	1.05	20,546		1.16	22,636		1.30	25,410		1.34	27,076		1.34	
Home improvement	24,293	1.25	12,605		0.71	6,993		0.40	9,439		0.50	12,778		0.63	
Automobile	61,469	3.15	67,630		3.81	68,140		3.90	77,621		4.10	99,844		4.92	
Other	15,911	0.82	18,623		1.05	22,434		1.28	25,886		1.37	27,827		1.37	
Total consumer loans	477,271	24.48	450,521		25.38	431,949		24.73	415,328		21.96	441,366		21.77	
Commercial business loans	70,170	3.60	75,022		4.23	61,060		3.50	60,932		3.22	59,844		2.95	
Total loans receivable	1,949,682	100.00%	1,775,013		100.00%	1,746,980		100.00%	1,891,748		100.00%	2,027,918		100.00%	
Less:															
Undisbursed loan proceeds	60,653		47,743			46,048			44,467			37,490			
Allowance for loan losses	13,923		13,771			12,743			12,245			12,238			
Deferred fees and discounts	(779)		1,221			2,527			3,611			5,554			
Total loans receivable, net	\$ 1,875,885		\$ 1,712,278			\$ 1,685,662			\$ 1,831,155			\$ 1,972,636			

At December 31, 2004, our one- to four-family first mortgage loans were pledged as collateral under a blanket pledge to the Federal Home Loan Bank ("FHLB") of Chicago. As of December 31, 2004, there were no other significant concentrations of loans such as loans to a number of borrowers engaged in similar activities. The Company's mortgage loans, fixed equity, home equity lines of credit and home improvement loans are primarily secured by properties housing one- to four-families which are generally located in our local lending areas in Wisconsin.

*Loan Maturity.* The following table presents the contractual maturity of our loans at December 31, 2004. The table does not include the effect of prepayments or scheduled principal amortization.

At December 31, 2004				
	Mortgage Loans	Consumer Loans	Commercial Business Loans	Total
	(In thousands)			
<b>Amounts Due:</b>				
Within one year	\$ 54,988	\$ 38,341	\$26,653	\$ 119,982
After one year				
One to two years	79,333	29,305	16,560	125,198
Two to three years	37,258	34,138	11,570	82,966
Three to five years	52,058	46,862	9,420	108,340
Five to ten years	129,476	256,015	4,995	390,486
Ten to twenty years	492,343	72,101	972	565,416
Over twenty years	556,785	509	-	557,294
Total due after one year	1,347,253	438,930	43,517	1,829,700
Total loans receivable	\$1,402,241	\$477,271	\$70,170	1,949,682
<b>Less:</b>				
Undisbursed loan proceeds				60,653
Allowance for loan losses				13,923
Deferred loan fees				(779)
Net loans receivable				<u>\$1,875,885</u>

The following table presents, as of December 31, 2004, the dollar amount of all loans due after December 31, 2005, and whether these loans have fixed interest rates or adjustable interest rates.

Due after December 31, 2005			
	Fixed	Adjustable	Total
	(In thousands)		
Mortgage loans	\$513,564	\$833,689	\$1,347,253
Consumer loans	299,857	139,073	438,930
Commercial business loans	34,057	9,460	43,517
 Total loans due after one year	 \$847,478	 \$982,222	 \$1,829,700



The following table presents a summary of our lending activity.

	For the year ended December 31,		
	2004	2003	2002
	(In thousands)		
Balance outstanding at beginning of period	\$1,779,069	\$1,793,951	\$1,923,799
<b>Originations:</b>			
Mortgage loans	479,814	899,766	752,771
Consumer loans	268,521	301,665	293,320
Commercial business loans	41,018	49,646	27,141
	789,353	1,251,077	1,073,232
<b>Purchases:</b>			
One-to four-family mortgage loans	148,951	41,214	4,042
<b>Less:</b>			
Principal payments and repayments:			
Mortgage loans	349,951	525,853	533,407
Consumer loans	241,771	283,093	276,699
Commercial business loans	45,395	35,684	27,013
Total principal payments	637,117	844,687	837,119
Transfers to foreclosed properties, real estate owned and repossessed assets	5,045	1,461	1,406
<b>Loan sales:</b>			
Mortgage loans	120,067	461,082	368,597
Commercial loans	475	-	-
Total loan sales	120,542	461,082	368,597
Total loans receivable and loans held for sale	\$1,954,669	\$1,779,069	\$1,793,951

**Residential Mortgage Lending.** Our primary lending activity has been the origination and purchases of first mortgage loans secured by one- to four-family properties, within our primary lending area. Most of these loans are owner-occupied; however, we do originate first mortgage loans on second homes, seasonal homes, and investment properties. In addition to our loan originations, we have purchased one- to four-family first mortgage loans of \$149.0 million in 2004, \$41.2 million in 2003, and \$4.0 million in 2002. We review each purchased loan for compliance with our underwriting standards, and generally only invest in loans which are located in the midwestern United States.

We offer conventional fixed rate mortgage loans and ARM loans with maturity dates up to 30 years. Residential mortgage loans generally are underwritten to Federal National Mortgage Association ("Fannie Mae") standards. All ARM mortgage loans and some fixed rate mortgage loans with maturities of up to 20 years are held in our portfolio. Fixed rate mortgage loans with maturities greater than 15 years typically are sold without recourse, servicing retained, into the secondary market. As a result of market competition, during the past few years, we have generally not charged loan origination fees. The interest rates charged on mortgage loan originations at any given date will vary, depending upon conditions in the local and secondary markets.

We also originate "jumbo single family mortgage loans" in excess of the Fannie Mae maximum loan amount, which was \$333,700 for single family homes in 2004. Effective for 2005, the maximum loan amount increased to \$359,650. Fannie Mae has higher limits for two-, three- and four-family homes. Fixed rate jumbo mortgage loans generally are sold servicing released without recourse to secondary market purchasers of such loans. ARM jumbo mortgage loans are underwritten in accordance with our underwriting guidelines and are retained in our loan portfolio. All jumbo mortgage loans originated in 2004 were ARMs.

Mortgage loan originations are solicited from real estate brokers, builders, existing customers, community groups, other referral sources, and residents of the local communities located in our primary market area through our loan origination staff. We also advertise our mortgage loan products through local newspapers, periodicals, internal customer communications and our website.

In addition to offering loans that conform to underwriting standards that are based on standards specified by Fannie Mae ("conforming loans"), we also originate a limited amount of non-conforming loans, due to size or underwriting considerations, for our own portfolio or for sale. Loans may be fixed rate one- to four-family mortgage loans or adjustable rate one- to four-family mortgage loans with maturities of up to 30 years. The average size of our one- to four-family mortgage loans originated in 2004 was \$135,965, and in 2003 and 2002 was approximately \$113,723 and \$114,000, respectively. We are an approved seller/servicer for Fannie Mae, Freddie Mac, the FHLB of Chicago's Mortgage Partnership Finance Program, Wisconsin Housing and Economic Development Authority ("WHEDA") and Wisconsin Department of Veterans Affairs ("WDVA").

The focus of our residential mortgage loan portfolio is the origination of 30 year ARM loans with interest rates adjustable in one, two, three, or five years. ARM loans typically are adjusted by a maximum of 200 basis points per adjustment period. The adjustments are usually annual, after the initial interest rate lock period. Prior to the merger of the subsidiary banks, there was a lifetime cap of 6% above the origination rate for First Northern Savings Bank and a lifetime interest rate cap of 12.9% for Mutual Savings Bank. Since March 2003, the Bank is originating ARM loans with a lifetime cap of 6% above the origination rate. Monthly payments of principal and interest are adjusted when the interest rate adjusts. We do not offer ARM loans which provide for negative amortization. The initial rates offered on ARM loans fluctuate with general interest rate changes and are determined by competitive conditions and our yield requirements. We currently utilize the monthly average yield on United States treasury securities, adjusted to a constant maturity of one year ("constant treasury maturity index") as the index to determine the interest rate payable upon the adjustment date of our ARM loans. Some of the ARM loans are granted with conversion options which provide terms under which the borrower may convert the mortgage loan to a fixed rate mortgage loan for a limited period early in the term (normally in the first five years) of the ARM loan. The terms at which the ARM loan may be converted to a fixed rate loan are established at the date of loan origination and are set at a level allowing us to sell the loan into the secondary market upon conversion.

ARM loans may pose credit risks different from the risks inherent in fixed rate loans, primarily because as interest rates rise, the underlying payments from the borrowers rise, thereby increasing the potential for payment default. At the same time, the marketability of the underlying property may be adversely affected by higher interest rates.

The volume and types of ARM loans we originate have been affected by the level of market interest rates, competition, consumer preferences and the availability of funds. Although we will continue to offer ARM loans, we cannot guarantee that we will be able to originate a sufficient volume of ARM loans to increase or maintain the proportion that these loans bear to our total loans.

In addition to conventional fixed rate and ARM loans, we are authorized to originate mortgages utilizing various government programs, primarily the Guaranteed Rural Housing Program. We also participate in two state-sponsored mortgage programs operated by WHEDA and WDVA. We originate these state-sponsored loans as an agent and assign them to the agency immediately after closing. Servicing is retained by us on both WHEDA and WDVA loans.

Most residential mortgage loans are processed under the Fannie Mae alternative documentation programs. For reduced documentation loans, we require applicants to complete a Fannie Mae loan application and request income, asset and debt information from the borrower. In addition to obtaining outside vendor credit reports on all borrowers, we also look at other information to ascertain the creditworthiness of the borrower. In most instances, we utilize Fannie Mae's "Desktop Underwriter" automated underwriting process to further reduce the necessary documentation. For example, a simplified appraisal or inspection may be used to verify the value of the property. Loans that are processed with reduced documentation conform to secondary market standards and generally may be sold on the secondary market.

Normally, an appraisal of the real estate to secure the loan is required, which must be performed by a certified appraiser approved by the board of directors; however, we utilize a streamline process on certain existing mortgage loans which will be refinanced. On such loans we do not require an appraisal and in essence the only items that are modified are the rate and term. A title insurance policy is required on all real estate first mortgage loans. Evidence of adequate hazard insurance and flood insurance, if applicable, is required prior to closing. Borrowers are required to make monthly payments to fund principal and interest (except on a few interest only mortgage loans) as well as private mortgage insurance and flood insurance, if applicable. With some exceptions for lower loan-to-value ratio loans, borrowers also generally are required to escrow in advance for real estate taxes. We make disbursements for these items from the escrow account as the obligations become due.

Our Underwriting Department reviews all pertinent information prior to making a credit decision to approve or deny an application. All recommendations to deny are reviewed by a designated senior officer of the Bank, in addition to the Underwriting Department, prior to the final disposition of the loan application. Our lending policies generally limit the maximum loan-to-value ratio on one- to four-family mortgage loans secured by owner-occupied properties to 100% of the lesser of the appraised value or purchase price of the property. Loans above 80% loan-to-value ratios are subject to the availability of private mortgage insurance. Coverage is required to reduce our exposure to less than 80% of value.

Our originations of residential mortgage loans amounted to \$326.8 million in 2004, \$790.7 million in 2003, and \$695.0 million in 2002. A number of our mortgage loan originations have been the result of refinancing of our existing loans due to the relatively low interest rate levels over the past three years. Total refinancings of our existing mortgage loans were as follows:

<u>Period</u>	<u>Amount</u>	<u>Percentage of mortgage loan originations</u>
	(Dollars in millions)	
Year ended December 31, 2004	\$121.8	37.0%
Year ended December 31, 2003	381.1	53.1
Year ended December 31, 2002	278.6	40.1

In addition to our standard mortgage products, we have developed mortgage programs designed to specifically address the credit needs of low- to moderate-income home mortgage applicants and first-time home buyers. Among the features of the low- to moderate-income home mortgage and first-time home buyer's programs are lower down payments, no mortgage insurance, and generally less restrictive requirements for qualification compared to our traditional one- to four-family mortgage loans. For instance, certain of these programs currently provide for loans with up to 97% loan-to-value ratios without private mortgage insurance.

*Consumer Loans.* We have been expanding our consumer loan originations because higher yields can be obtained, there is strong consumer demand for such products, and we have experienced relatively low delinquency and few losses on such products. In addition, we believe that offering consumer loan products helps to expand and create stronger ties to our existing customer base by increasing the number of customer relationships and providing cross-marketing opportunities. At December 31, 2004, \$477.3 million, or 24.5%, of our gross loan portfolio was in consumer loans. Consumer loan products offered within our market areas include home equity loans, home equity lines of credit, home improvement loans, automobile loans, recreational vehicle loans, marine loans, deposit account loans, overdraft protection lines of credit, unsecured consumer loans and also to a lesser extent, unsecured consumer loans through the Visa credit card programs (offered through Elan Financial Services) and federally guaranteed student loans.

Our focus in consumer lending has been the origination of home equity loans, home improvement loans, home equity lines of credit and automobile loans. At December 31, 2004, we had \$440.8 million or 92.4% of the consumer loan portfolio in such loans. Underwriting procedures for the home equity and home equity lines of credit loans include a comprehensive review of the loan application, an acceptable credit rating, verification of the value of the equity in the home and verification of the borrower's income. The loan-to-value ratio and the total debt-to-income ratio are two of the determining factors in the underwriting process. Home equity loan and home improvement loan originations are developed through the use of direct mail, cross-sales to existing customers, radio advertisement, and advertisements in local newspapers.

We make indirect automobile, boat and recreational vehicle loans through applications taken by selected dealers on application forms approved by us. The applications are delivered to Savings Financial Corporation ("SFC"), a 50% owned subsidiary of the Bank, for underwriting. If an application is approved, money is funded to the dealer and the loan becomes a part of the SFC portfolio. The SFC paper is then sold to either of the parent companies of SFC or to the Bank's subsidiary First Northern Investments Inc.

We originate both fixed rate and variable rate home equity loans and home improvement loans with combined loan-to-value ratios to 100%. Pricing on fixed rate home equity and home improvement loans is reviewed by management, and generally terms are in the three to fifteen year range in order to minimize interest rate risk. During 2004, we originated \$121.4 million of fixed rate home equity or home improvement loans; these loans carry a

weighted average written term of approximately 9.8 years and a fixed rate ranging from 3.99% to 9.99%. During 2003 we originated approximately \$163.3 million of fixed rate home equity or home improvement loans, carrying a weighted average written term of approximately 9.8 years and a fixed rate ranging from 3.25% to 10.25%. We also offer adjustable rate home equity and home improvement loans. At December 31, 2004, \$37.6 million or 12.9% of our fixed term home equity and home improvement loan portfolio carried an adjustable rate. The adjustable rate loans have an initial fixed rate for one to three years then adjust annually or monthly depending upon the offering, with terms of up to twenty years.

Our home equity credit line loans, which totaled \$88.4 million, or 18.5% of total consumer loans at December 31, 2004, are adjustable rate loans secured by a first or second mortgage on owner-occupied one- to four-family residences primarily located in the state of Wisconsin. Current interest rates on home equity credit lines are tied to the prime rate, adjust monthly after an initial interest rate lock period, and range from prime rate to 300 basis points over the prime rate, depending on the loan-to-value ratio. Home equity line of credit loans are made for terms up to 10 years and require a minimum monthly payment of interest only with a minimum payment of \$50 and on home equity line of credit loans with loan-to-value of 90% or greater require a minimum payment of \$50 or 1½% of the month end balance. An annual fee is charged on home equity lines of credit.

At December 31, 2004, student loans amounted to \$20.5 million, or 4.3% of our consumer loan portfolio. These loans are serviced by Great Lakes Higher Education Servicing Corporation.

*Multi-family and Commercial Real Estate Loans.* At December 31, 2004, our multi-family and commercial real estate loan portfolio was \$357.3 million or 18.3% of our total loans receivable. The multi-family and commercial real estate loan portfolios consist of fixed rate, ARM and balloon loans originated at prevailing market rates. This portfolio generally consists of loans secured by apartment buildings, office buildings, warehouses, industrial buildings and retail centers. These loans typically do not exceed 80% of the lesser of the purchase price or an appraisal by an appraiser designated by us. Balloon loans generally are amortized on a 15 to 30 year basis with a typical loan term of 3 to 10 years.

Loans secured by multi-family and commercial real estate are granted based on the income producing potential of the property and the financial strength of the borrower. The net operating income, which is the income derived from the operation of the property or from the business in an owner-occupied property, must be sufficient to cover the payments relating to the outstanding debt. In most cases, we obtain joint and several personal guarantees from the principals involved. We generally require an assignment of rents or leases in order to be assured that the cash flow from the property will be used to repay the debt. Appraisals on properties securing multi-family and larger commercial real estate loans are performed by independent state certified fee appraisers approved by the board of directors. Title and hazard insurance are required as well as flood insurance, if applicable. Environmental assessments are performed on certain multi-family and commercial real estate loans in excess of \$1.0 million. In addition, an annual review is performed by us on non-owner-occupied multi-family and commercial real estate loans over \$1.0 million.

At December 31, 2004, the largest outstanding loan on a multi-family property was \$14.2 million on a 113 unit apartment project (including 12,000 feet of retail space) located in Madison, Wisconsin. At the same date, the largest outstanding loan on a commercial real estate property was \$6.7 million on a retail building located in Kenosha, Wisconsin. At December 31, 2004, these loans were current and performing in accordance with their terms. These loans are substantially below the legal lending limit to a single borrower, which was approximately \$77.9 million at December 31, 2004.

Loans secured by multi-family and commercial real estate properties are generally larger and involve a greater degree of credit risk than one- to four-family residential mortgage loans. Such loans typically involve large balances to single borrowers or groups of related borrowers. Because payments on loans secured by multi-family and commercial real estate properties are often dependent on the successful operation or management of the properties, repayment of such loans may be subject to adverse conditions in the real estate market or the economy. If the cash flow from the project decreases, or if leases are not obtained or renewed, the borrower's ability to repay the loan may be impaired.

*Construction and Development Loans.* At December 31, 2004, our construction and development mortgage loan portfolio was \$141.4 million, or 7.3% of our total loans receivable. At that date, commercial real estate loans were \$94.3 million or 66.7% and multi-family mortgage loans were \$47.1 million or 33.3% of the total construction and development loans. As a general matter, construction and development loans convert to permanent loans on our

books. These types of credits carry special repayment risk because if a borrower defaults the construction project needs to be completed before the full value of the collateral can be realized.

**Commercial Business Loans.** At December 31, 2004, our commercial business loan portfolio consisted of loans totaling \$70.2 million or 3.6% of our total loans receivable. The commercial loan portfolio consists of loans to businesses for equipment purchases, working capital lines of credit, debt refinancing, SBA loans and domestic stand-by letters of credit. Typically, these loans are secured by business assets and personal guarantees. We offer variable, adjustable and fixed rate loans. Approximately 29.1% of the commercial business loans have an interest rate adjusted monthly or immediately, with the majority based on the prevailing prime rate. We also have commercial business loans that have an initial period where interest rates are fixed, generally one to five years, and thereafter are adjustable based on various indexes. Fixed rate loans are priced at either a margin over the yield on US Treasury issues with maturities that correspond to the maturities of the notes or to match competitive conditions and yield requirements. Term loans are generally amortized over a three to seven year period and line-of-credit commercial business loans generally have a term of one year, at which point they mature. All borrowers having an exposure to the Bank of \$500,000 or more are reviewed annually. The largest commercial business loan at December 31, 2004 had an outstanding balance of \$25.5 million and was secured by equipment and chattel paper.

### **Loan Approval Authority**

For one- to four-family residential loans intended for sale into the secondary market, the underwriters are authorized by the board of directors to approve loans processed through the Fannie Mae "Desktop Underwriter" automated underwriting system up to the Fannie Mae conforming loan limits (\$359,650 for a single family residential units; higher limits for two-, three-, and four-family units). For one- to eight-family residential loans intended to be held in the Bank's portfolio, the underwriters are authorized to approve loans processed through the Fannie Mae "Desktop Underwriter" automated underwriting system up to \$359,650, provided the loan-to-value is 80% or less and the loan meets other specific underwriting criteria. All portfolio loans in excess of \$359,650, with a loan-to-value greater than 80%, or failing to meet other specific underwriting criteria must be approved by a senior officer.

Consumer loan underwriters have individual approval authority for secured loans ranging from \$20,000 to \$100,000 provided the loan-to-value on real estate does not exceed 80% or 90% on personal property and that the loan meets other specific underwriting criteria. All consumer loans in excess of \$100,000, with a loan-to-value greater than 80% on real estate, 90% on personal property, or failing to meet other specific underwriting criteria must be approved by a senior officer. Consumer loan underwriters have individual approval authority for unsecured loans ranging from \$2,000 to \$15,000 provided the loan meets other specific underwriting criteria. All unsecured consumer loans in excess of \$15,000, or not meeting specific underwriting criteria, must be approved by a senior officer.

Individual lenders and senior officers in the investment real estate department have lending authority of \$250,000 for multi-family and commercial loan proposals for both existing and proposed construction of investment real estate properties. Two senior officers together have lending authority of \$500,000 for investment real estate loans. All investment real estate loans over \$500,000 require approval of the executive committee of the board of directors.

Individual lenders in the commercial banking department have individual lending authority ranging from \$50,000 to \$150,000 for secured commercial business loans. Senior officers have individual lending authority of \$250,000 and two senior officers together have lending authority of \$500,000 for secured commercial business loans. All secured business loans over \$500,000 require approval of the executive committee of the board of directors. Individual lenders in the commercial banking department have individual lending authority ranging from \$10,000 to \$25,000 for unsecured commercial business loans. Senior officers have individual lending authority of \$50,000 and two senior officers together have lending authority of \$150,000 for unsecured commercial business loans. All unsecured business loans over \$150,000 require approval of the executive committee of the board of directors.

All loans approved by individuals and senior officers must be ratified by the board of directors at the next meeting following the approval.

## Asset Quality

One of our key operating objectives has been and continues to be to maintain a high level of asset quality. Through a variety of strategies, including, but not limited to, borrower workout arrangements and aggressive marketing of foreclosed properties and repossessed assets, we have been proactive in addressing problem and non-performing assets. These strategies, as well as our emphasis on quality loan underwriting, our maintenance of sound credit standards for new loan originations, annual evaluation of large credits and relatively favorable economic and real estate market conditions have resulted in historically low delinquency ratios.

*Delinquent Loans and Foreclosed Assets.* When a borrower fails to make required payments on a loan, we take a number of steps to induce the borrower to cure the delinquency and restore the loan to a current status. In the case of one- to four-family mortgage loans, our loan servicing department is responsible for collection procedures from the 15th day of delinquency through the completion of foreclosure. Specific procedures include a late charge notice being sent at the time a payment is over 15 days past due with a second notice (in the form of a billing coupon) being sent before the payment becomes 30 days past due. Once the account is 30 days past due, we attempt telephone contact with the borrower. Letters are sent if contact has not been established by the 45th day of delinquency. On the 60th day of delinquency, attempts at telephone contact continue and stronger letters, including foreclosure notices, are sent. If telephone contact cannot be made, we send either our property inspector, a qualified third party inspector, or a loan officer to the property in an effort to contact the borrower.

When contact is made with the borrower, we attempt to obtain full payment or work out a repayment schedule to avoid foreclosure. All properties are inspected prior to foreclosure approval. Most borrowers pay before the deadline given and it is not necessary to start a foreclosure action. If it is, action starts when the loan is between the 90th and 120th day of delinquency following review by a senior officer. In conjunction with commencing a foreclosure action, we perform a property evaluation or in some cases, we do a loan file analysis to determine any potential loss. If there is a potential loss, an appropriate charge-off is taken to bring the loan balance in line with the value of the liquidated real estate. Charge-offs are reported to the board of directors. If the loan is deemed to be uncollectible, we seek the shortest redemption period possible thus waiving our right to collect any deficiency from the borrower. If we obtain the property at the foreclosure sale, we hold the property as real estate owned. We obtain a market evaluation of the property to determine that the carrying balance of the owned real estate is consistent with the market value of the property. Marketing of the property begins immediately following the Bank taking title to the property. The marketing is usually undertaken by a realtor knowledgeable of the particular market. Mortgage insurance claims are filed if the loan had mortgage insurance coverage. It is marketed after a market evaluation is obtained and any mortgage insurance claims are filed. The collection procedures and guidelines as outlined by Fannie Mae, Freddie Mac, Veterans Administration (VA), WHEDA, and Guaranteed Rural Housing are followed.

The collection procedures for consumer loans, excluding student loans, indirect consumer loans and credit card loans, include sending periodic late notices to a borrower once a loan is 5 to 15 days past due depending upon the grace period associated with a loan. We attempt to make direct contact with a borrower once a loan becomes 30 days past due. Supervisory personnel review loans 90 days or more delinquent on a regular basis. If collection activity is unsuccessful after 90 days, we may pursue legal remedies ourselves or refer the matter to our legal counsel for further collection effort or charge-off a loan. Loans we deem to be uncollectible, or partially uncollectible are charged off so that the carrying balance approximates the value of the collateral. Charge-offs of consumer loans require the approval of a senior officer and are reported to the board of directors. All student loans are serviced by the Great Lakes Higher Education Servicing Corporation which guarantees their servicing to comply with all Department of Education Guidelines. Our student loan portfolio is guaranteed by the Great Lakes Higher Education Guaranty Corporation, which is reinsured by the U.S. Department of Education. Credit card loans are serviced by Elan Financial Services.

The collection procedures for multi-family, commercial real estate and commercial business loans include sending periodic late notices to a borrower once a loan is past due. We attempt to make direct contact with a borrower once a loan becomes 15 days past due. Our managers of the multi-family and commercial real estate loan areas review loans 10 days or more delinquent on a regular basis. If collection activity is unsuccessful, we may refer the matter to our legal counsel for further collection effort. Within 90 days, loans we deem to be uncollectible are proposed for repossession or foreclosure and partial or full charge-offs are taken to bring the loan balance in line with the expected collectibility of the loans. This legal action requires the approval of our board of directors, and charge offs are reported to the board.

Our policies require that management continuously monitor the status of the loan portfolio and report to the board of directors on a monthly basis. These reports include information on delinquent loans and foreclosed real estate.

The following table presents information regarding non-accrual mortgage, consumer loans, commercial business loans, accruing loans delinquent 90 days or more, and foreclosed properties and repossessed assets as of the dates indicated.

	At December 31,				
	2004	2003	2002	2001	2000
Non-accrual mortgage loans	\$1,485	\$ 2,894	\$1,399	\$1,814	\$730
Non-accrual consumer loans	619	961	527	444	383
Non-accrual commercial business loans	3,579	5,433	5,357	346	750
Accruing loans delinquent 90 days or more	586	1,084	1,108	936	1,258
Total non-performing loans	6,269	10,372	8,391	3,540	3,121
Foreclosed properties, real estate owned and repossessed assets, net	1,621	630	750	383	2,281
Total non-performing assets	\$7,890	\$11,002	\$9,141	\$3,923	\$5,402
Non-performing loans to total loans	0.33%	0.61%	0.50%	0.19%	0.16%
Non-performing assets to total assets	0.23%	0.35%	0.32%	0.14%	0.19%
Interest income that would have been recognized if non-accrual loans had been current	\$831	\$384	\$375	\$139	\$77

There were no significant loans, which were considered to be impaired as defined in Statement of Financial Accounting Standards ("SFAS") No. 114 at December 31, 2002, 2001 or 2000. At December 31, 2004, there were loans totaling \$8.7 million that are considered to be impaired as compared to \$17.0 million at December 31, 2003. The average impaired loans for the year ended December 31, 2004 was \$8.7 million and the interest received and recognized on the impaired loans was \$29,073.

There are no restructured loans at the dates presented.

Total non-performing loans decreased as of December 31, 2004, as compared to December 31, 2003, primarily as a result of a decrease in non-accrual mortgage and commercial business loans. The decrease resulted primarily from the transfer of \$3.1 million of commercial non-performing loans to real estate owned and \$1.3 million of mortgage loans to foreclosure. Total non-performing loans increased as of December 31, 2003, as compared to December 31, 2002, primarily as a result of an increase in non-accrual business loans. Of the increase during 2002, \$3.2 million related to a single commercial business borrower with the remaining portion of the increase a result of the general decline in economic conditions affecting the borrower's cash flow. We believe non-performing loans and assets, expressed as a percentage of total loans and assets, are below national averages for financial institutions, due in part to our loan underwriting standards.

The ultimate results with these and other commercial loans will depend on the success of the related business or projects, economic performance and other factors affecting loans and borrowers.

With the exception of mortgage loans insured or guaranteed by the FHA, VA, Guaranteed Rural Housing and student loans, we stop accruing income on loans when interest or principal payments are greater than 90 days in arrears or earlier when the timely collectibility of such interest or principal is doubtful. We designate loans on which we stop accruing income as non-accrual loans and generally, we reverse outstanding interest that we previously credited to income. We may recognize income in the period that we collect it when the ultimate collectibility of principal is no longer in doubt. We return a non-accrual loan to accrual status when factors indicating doubtful collection no longer exist. We had \$5.7 million, \$9.3 million and \$7.3 million of non-accrual loans at December 31, 2004, 2003 and 2002, respectively. Interest income that would have been recognized had such loans been performing in accordance with their contractual terms totaled approximately \$831,000, \$384,000 and \$375,000 for the years ended December 31, 2004, 2003 and 2002, respectively. A total of approximately \$83,000, \$381,000 and \$499,000 of interest income was actually recorded on such loans in 2004, 2003 and 2002, respectively.

All commercial business and commercial real estate loans which are greater than 90 days past due are considered to be potentially impaired. In addition, we may declare a loan impaired prior to a loan being 90 days past due, if we determine there is a question as to the collectibility of principal. Impaired loans are individually assessed to

determine whether a loan's carrying value is in excess of the fair value of the collateral or the present value of the loan's cash flows discounted at the loan's effective interest rate and if the carrying value is in excess, a loan loss allowance will be established.

Foreclosed real estate consists of property we acquired through foreclosure or deed in lieu of foreclosure. Foreclosed properties increased in 2004 as compared to 2003 primarily as a result of the transfer of non-performing commercial loans and mortgage loans to foreclosed properties, real estate owned or repossessed assets. During the year, we transferred \$4.4 million of these loans. Foreclosed real estate properties are initially recorded at the lower of the recorded investment in the loan or fair value. Thereafter, we carry foreclosed real estate at fair value less estimated selling costs. Foreclosed real estate is inspected periodically. Additional outside appraisals are obtained as deemed necessary. Additional write-downs may occur if the property value deteriorates. These additional write-downs are charged directly to current operations.

**Charge-offs.** The Company will charge off a loan when the fair market value of the underlying collateral or anticipated cash flow discounted at the contract rate, is less than the loan amount. Charge-offs of commercial loans increased in 2004 as compared to 2003 primarily as a result of one large commercial loan.

**Allowance for Loan Losses.** The following table presents the activity in our allowance for loan losses at or for the periods indicated.

	At or for the Years Ended December 31,				
	2004	2003	2002	2001	2000
	(Dollars in thousands)				
Balance at beginning of period	\$13,771	\$12,743	\$12,245	\$12,238	\$6,948
Provision for loan losses	1,330	1,304	760	723	423
Purchase of First Northern	—	—	—	—	5,028
Charge-offs:					
Mortgage loans	(64)	(67)	(14)	(65)	(38)
Consumer loans	(373)	(415)	(428)	(337)	(156)
Commercial business loans	(816)	(19)	(39)	(415)	—
Total charge-offs	(1,253)	(501)	(481)	(817)	(194)
Recoveries:					
Mortgage loans	9	113	66	26	1
Consumer loans	66	107	40	57	32
Commercial business loans	—	5	113	18	—
Total recoveries	75	225	219	101	33
Net (charge-offs) recoveries	(1,178)	(276)	(262)	(716)	(161)
Balance at end of period	\$13,923	\$13,771	\$12,743	\$12,245	\$12,238
Net charge-offs to average loans	(0.07%)	(0.02%)	(0.01%)	(0.04%)	(0.01%)
Allowance for loan losses to total loans	0.74%	0.80%	0.76%	0.67%	0.62%
Allowance for loan losses to non-performing loans	222.09%	132.77%	151.87%	345.90%	392.12%

The allowance for loan losses has been determined in accordance with generally accepted accounting principles. We are responsible for the timely and periodic determination of the amount of the allowance required. We believe that our allowance for loan losses is adequate to cover specifically identifiable loan losses, as well as estimated losses inherent in our portfolio for which certain losses are probable but not specifically identifiable.

Loan loss allowances are reviewed monthly. General allowances are maintained by the following categories for performing loans to provide for unidentified inherent losses in the portfolios:

- One- to four-family
- Consumer
- Multi-family and commercial real estate



- Commercial business

Various factors are taken into consideration in establishing the loan loss allowance including: historical loss experience, economic factors, loans without escrow accounts and other factors, that, in management's judgment would affect the collectibility of the portfolio as of the evaluation date. Adjustments to the allowance for loan losses are charged against operations as provision for loan losses.

The appropriateness of the allowance is reviewed by senior management based upon its evaluation of then-existing economic and business conditions affecting the key lending areas of the Bank. Other outside factors such as credit quality trends, collateral values, loan volumes and concentrations, specific industry conditions within portfolio segments and recent loss experience in particular segments of the portfolio that existed as of the balance sheet date and the impact that such conditions were believed to have had on the collectibility of the loan are also considered.

*Non-performing and Delinquent Loans.* One- to four-family loans delinquent more than 90 days, multi-family and commercial real estate loans delinquent more than 30 days, consumer loans delinquent more than 90 days and commercial business loans delinquent more than 30 days are reviewed and analyzed by senior officers on an individual basis. Any loss is charged against the allowance by establishing a corresponding specific allowance for that loan from the general allowance. In such an event, the loan is then reduced by the amount of the specific allowance and a corresponding amount is charged off to the allowance for losses on loans.

By following careful underwriting guidelines, we have historically maintained low levels of non-performing loans to total loans. Our ratio of non-performing loans to total loans at December 31, 2000 was 0.16%, after which it increased somewhat. At December 31, 2004, the ratio was 0.33%. This recent decrease as compared to December 31, 2003 and 2002 was the result of decreased delinquencies on the entire loan portfolio and the foreclosure or acquisition of the collateral by the Bank and subsequent liquidation of a large commercial loan. At December 31, 2004, the recorded investment in loans that are considered to be impaired under SFAS No. 114 was \$8.7 million.

We believe the primary risks inherent in our portfolio are possible increases in interest rates, a possible weak economy, generally, and a possible decline in real estate market values. Any one or a combination of these events may adversely affect our loan portfolio resulting in increased delinquencies and loan losses. Accordingly, and because of the increased dollar amount of consumer loans and composition of the loan portfolio, we have taken steps to increase our level of loan loss allowances over the last 5 years. At December 31, 2004, the allowance for loan losses as a percentage of total loans was 0.74% compared with 0.62% at December 31, 2000. Furthermore, the increase in the allowance for loan losses each year from 2000 to 2004 reflects our strategy of providing allowances for inherent losses in the portfolio, identifying potential losses in a timely manner, and providing an allowance to reflect changes in the components of the portfolio during that period.

Although we have established and maintained the allowance for loan losses at an amount that reflects management's best estimate of the amount necessary to provide for probable and estimable losses on loans, future additions may be necessary if economic and other conditions in the future differ substantially from the current operating environment and as the loan portfolio grows and its composition changes. In addition, various regulatory agencies, as an integral part of their examination process, periodically review our loan and foreclosed real estate portfolios and the related allowance for loan losses and valuation allowance for foreclosed real estate. One or more of these agencies, specifically the OTS or the Federal Deposit Insurance Corporation ("FDIC"), may require us to increase the allowance for loan losses or the valuation allowance for foreclosed real estate based on their judgments of information available to them at the time of their examination, thereby adversely affecting our results of operations.

See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Comparison of Operating Results for the Years Ended December 31, 2004 and 2003—Provision for Loan Losses.” The following table represents our allocation of allowance for loan losses by loan category on the dates indicated:

At December 31,										
Loan Category	2004		2003		2002		2001		2000	
	Percentage of Loans in Category to Total		Percentage of Loans in Category to Total		Percentage of Loans in Category to Total		Percentage of Loans in Category to Total		Percentage of Loans in Category to Total	
	Amount	Loans	Amount	Loans	Amount	Loans	Amount	Loans	Amount	Loans
Mortgage loans										
One- to four-family	\$ 2,488	46.34%	\$ 4,001	44.69%	\$4,701	47.37%	\$5,608	52.46%	\$6,279	59.56%
Other	3,222	25.58	3,150	25.70	3,160	24.40	2,875	22.36	2,173	15.72
Total mortgage loans	5,710	71.92	7,151	70.39	7,861	71.77	8,483	74.82	8,452	75.28
Home equity lines	663	4.54	481	4.43	496	4.45	490	4.04	519	3.97
Consumer	2,929	19.94	2,398	20.95	2,380	20.28	2,320	17.92	2,483	17.80
Commercial business loans	4,416	3.60	3,741	4.23	1,507	3.50	952	3.22	784	2.95
Unallocated	205	-	-	-	499	0.00	-	0.00	-	0.00
Total allowance for loan losses	\$13,923	100.00%	\$13,771	100.00%	\$12,743	100.00%	\$12,245	100.00%	\$12,238	100.00%

### Investment Activities

**Investment Securities.** The Bank’s board of directors reviews and approves its investment policy on an annual basis. Senior officers, as authorized by the board of directors, implement this policy. The board of directors reviews investment activity on a monthly basis.

Our investment objectives are to meet liquidity requirements, generate a favorable return on investments without undue compromise to our other business objectives and our levels of interest rate risk, credit risk and investment portfolio concentrations. Federally chartered savings banks have authority to invest in various types of assets, including U.S. Treasury obligations, securities of various federal agencies, state and municipal obligations, mortgage-related securities, mortgage derivative securities, certain time deposits of insured banks and savings institutions, certain bankers’ acceptances, repurchase agreements, loans of federal funds, and, subject to certain limits, corporate debt and equity securities, commercial paper and mutual funds.

The Bank’s investment policy allows participation in hedging strategies such as the use of financial futures, options or forward commitments or interest rate swaps but only with prior approval of the board of directors. We did not have any investment hedging transactions in place at December 31, 2004. Our investment policy prohibits the purchase of non-investment grade bonds. Our investment policy also provides that we will not engage in any practice that the Federal Financial Institutions Examination Council considers to be an unsuitable investment practice. For information regarding the carrying values, yields and maturities of our investment securities and mortgage-related securities, see “—Carrying Values, Yields and Maturities.”

At December 31, 2004, we had not invested funds in any single mutual fund in excess of 10% of our capital. All of our mutual fund investments are permissible investments under our investment policy and applicable laws and regulations. We carry our mutual fund investments at market value. At December 31, 2004, our mutual fund investments were in funds which invested primarily in mortgage-related securities.

We classify securities as trading, held-to-maturity, or available-for-sale at the date of purchase. At December 31, 2004, all investment securities are classified as available-for-sale. These securities are carried at fair value with the change in fair value recorded as a component of shareholders’ equity.

**Mortgage-related Securities.** Most of our mortgage-related securities are directly or indirectly insured or guaranteed by the Government National Mortgage Association (“GNMA”), Freddie Mac or Fannie Mae. The rest of the securities are investment-grade private placement collateralized mortgage obligations (“CMOs”). Private placement CMOs carry higher credit risks and higher yields than mortgage-related securities insured or guaranteed by agencies of the U.S. Government. We classify our entire mortgage-related securities portfolio as available-for-sale.

At December 31, 2004, mortgage-related securities available-for-sale totaled \$1.3 billion, or 36.8% of total assets. At December 31, 2004, the mortgage-related securities portfolio had a weighted average yield of 4.31%. Of the mortgage-related securities we held at December 31, 2004, \$1.2 billion, or 95.5%, had fixed rates and \$57.4 million, or 4.5%, had adjustable-rates. Mortgage-related securities at December 31, 2004 included real estate mortgage investment conduits ("REMICs"), which are securities derived by reallocating cash flows from mortgage pass-through securities or from pools of mortgage loans held by a trust. REMICs are a form of, and are often referred to as CMOs.

Our CMOs have fixed and variable coupon rates ranging from 2.25% to 6.00% and a weighted average yield of 4.24% at December 31, 2004. At December 31, 2004, CMOs totaled \$1.1 billion, which constituted 89.9% of the mortgage-related securities portfolio, or 33.0% of total assets. Our CMOs had an expected average life of 3.1 years at December 31, 2004. For a further discussion of our investment policies, including those for mortgage-related securities, see "—Investment Securities." Purchases of mortgage-related securities may decline in the future to offset any significant increase in demand for one- to four-family mortgage loans and other loans.

Mortgage-related securities generally yield less than the loans that underlie such securities because of the cost of payment guarantees or credit enhancements that reduce credit risk. However, mortgage-related securities are more liquid than individual mortgage loans.

In general, mortgage-related securities issued or guaranteed by GNMA, Freddie Mac and Fannie Mae are weighted at no more than 20% for risk-based capital purposes, compared to the 50% risk weighting assigned to most non-securitized residential mortgage loans.

While mortgage-related securities carry a reduced credit risk as compared to whole loans, they remain subject to the risk of a fluctuating interest rate environment. Along with other factors, such as the geographic distribution of the underlying mortgage loans, changes in interest rates may alter the prepayment rate of those mortgage loans and affect the value of mortgage-related securities.

The following table presents our investment securities and mortgage-related securities activities for the periods indicated.

	For the Year Ended December 31,		
	2004	2003	2002
	(In thousands)		
<b>Investment securities available-for-sale:</b>			
Carrying value at beginning of period	\$ 67,854	\$ 73,247	\$ 93,080
Purchases	26,480	128,501	36,390
Sales	-	(8,076)	-
Calls	-	(700)	(4,023)
Maturities	(27,000)	(124,051)	(50,960)
Principal payments	-	-	(937)
Premium amortization and discount accretion, net	20	122	134
(Decrease) increase in unrealized gains	1,399	(1,189)	(437)
Net increase (decrease) in investment securities	899	(5,393)	(19,833)
Carrying value at end of period	\$ 68,753	\$ 67,854	\$ 73,247
<b>Mortgage-related securities available-for-sale:</b>			
Carrying value at beginning of period	\$1,053,349	\$ 618,123	\$ 521,084
Purchases	523,334	923,451	365,312
Principal payments	(302,848)	(470,994)	(275,518)
Premium amortization and discount accretion, net	(375)	(2,229)	(253)
Increase (decrease) in unrealized gains	(7,236)	(15,002)	7,498
Net increase in mortgage-related securities	212,875	435,226	97,039
Carrying value at end of period	\$1,266,224	\$1,053,349	\$ 618,123

The following table presents the fair value of our money market investments, investment securities and mortgage-related securities portfolios at the dates indicated. It also presents the coupon type for the mortgage-related securities portfolio. For all securities and for all periods presented, the carrying value is equal to fair value.

At December 31,			
	2004	2003	2002
	Carrying/ Fair Value	Carrying/ Fair Value	Carrying/ Fair Value
	(Dollars in thousands)		
<b>Money market investments</b>			
Interest-earning deposits	\$ 707	\$20,119	\$ 36,462
Federal funds sold	-	30,000	165,000
Total money market investments	\$ 707	\$50,119	\$201,462
<b>Investment securities available-for-sale</b>			
Mutual funds	\$45,390	\$44,697	\$34,034
United States government and federal agency obligations.	19,831	21,736	28,212
Corporate issue securities	-	-	9,563
Stock in federal agencies	3,532	1,421	1,438
Total investment securities available-for-sale	\$68,753	\$67,854	\$73,247
<b>Mortgage-related securities available-for-sale by issuer:</b>			
Freddie Mac	\$ 631,024	\$ 518,172	\$288,113
Fannie Mae	542,803	445,496	296,604
Private placement CMO's	9,928	543	8,406
GNMA	82,469	89,138	25,000
Total mortgage-related securities	\$1,266,224	\$1,053,349	\$618,123
<b>Total investment portfolio</b>	<b>\$1,335,684</b>	<b>\$1,171,322</b>	<b>\$892,832</b>

**Carrying Values, Yields and Maturities.** The table below presents information regarding the carrying values, weighted average yields and contractual maturities of our investment securities and mortgage-related securities at December 31, 2004. Mortgage-related securities are presented by issuer and by coupon type.

	At December 31, 2004									
	One Year or Less		More than One Year to Five Years		More than Five Years to Ten Years		More than Ten Years		Total	
	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield
(Dollars in thousands)										
<b>Investment securities available-for-sale:</b>										
Mutual funds	\$45,390	2.59%	\$—	—%	\$—	—%	\$—	—%	\$45,390	2.59%
United States government and agencies	5,294	5.3	14,537	2.19	—	—	—	—	19,831	3.01
Corporate issues	—	—	—	—	—	—	—	—	—	—
Taxable municipal	—	—	—	—	—	—	—	—	—	—
Stock in Federal Agencies	3,532	3.77	—	—	—	—	—	—	3,532	3.77
Total investment securities	<u>\$54,216</u>	<u>2.93</u>	<u>\$14,537</u>	<u>2.19</u>	<u>\$—</u>	<u>—</u>	<u>\$—</u>	<u>—</u>	<u>\$68,753</u>	<u>2.77</u>
<b>Mortgage-related securities available-for-sale:</b>										
<b>By issuer:</b>										
GNMA pass-through certificates	\$ 3	8.00	\$ 61	8.34	\$ —	—	\$ 1,836	4.02	\$ 1,900	
Fannie Mae pass-through certificates	—	—	1,281	5.90	54,440	5.41	67,620	4.59	123,341	4.96
Freddie Mac pass-through certificates	89	6.48	—	—	1,177	5.84	1,224	6.61	2,490	6.34
Private CMO's	—	—	—	—	81	6.15	9,847	5.48	9,928	5.49
Freddie Mac, Fannie Mae and GNMA-REMICs	—	—	1,211	5.17	91,755	3.65	1,035,599	4.27	1,128,565	4.23
Total mortgage-related securities	<u>\$ 92</u>	<u>6.52</u>	<u>\$ 2,553</u>	<u>5.61</u>	<u>\$147,453</u>	<u>4.31</u>	<u>\$1,116,126</u>	<u>4.31</u>	<u>\$1,266,224</u>	<u>4.31</u>
<b>By coupon type:</b>										
Adjustable rate	—	—	1,211	5.17	—	—	56,154	4.43	57,365	4.45
Fixed rate	92	6.52	1,342	6.01	147,453	4.31	1,059,972	4.30	1,208,859	4.30
Total mortgage-related securities	<u>\$ 92</u>	<u>6.52%</u>	<u>\$ 2,553</u>	<u>5.61%</u>	<u>\$147,453</u>	<u>4.31%</u>	<u>\$1,116,126</u>	<u>4.31%</u>	<u>\$1,266,224</u>	<u>4.31%</u>
Total investment and mortgage-related securities portfolio	<u>\$54,308</u>	<u>2.94%</u>	<u>\$17,090</u>	<u>2.70%</u>	<u>\$147,453</u>	<u>4.31%</u>	<u>\$1,116,126</u>	<u>4.31%</u>	<u>\$1,334,977</u>	<u>4.23%</u>

## Deposits

We offer a variety of deposit accounts having a range of interest rates and terms. We currently offer regular savings accounts (consisting of passbook and statement savings accounts), interest-bearing demand accounts, non-interest-bearing demand accounts, money market accounts, and time deposits. We also offer IRA time deposit accounts.

Deposit flows are influenced significantly by general and local economic conditions, changes in prevailing interest rates, pricing of deposits and competition. Our deposits are primarily obtained from areas surrounding our bank offices and we rely primarily on paying competitive rates, service, and long-standing relationships with customers to attract and retain these deposits. We have, from time to time, used brokers to obtain wholesale deposits to a limited extent. Early in 2005, we joined a wholesale deposit program called "CDARs" which could increase the amount of wholesale deposits. At December 31, 2004, we had approximately \$14.6 million of brokered wholesale deposits.

When we determine our deposit rates, we consider local competition, U.S. Treasury securities offerings and the rates charged on other sources of funds. Core deposits (defined as regular savings accounts, money market accounts and demand accounts) represented 42.4% of total deposits on December 31, 2004. At December 31, 2004, time deposits with remaining terms to maturity of one year or less amounted to \$584.2 million. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Gap Analysis."

The following table presents our deposit activity for the periods indicated:

	For the Year Ended December 31,		
	2004	2003	2002
	(Dollars in thousands)		
Total deposits at beginning of period	\$2,052,290	\$2,126,655	\$2,090,440
Net deposits (withdrawals)	(112,771)	(127,283)	(26,619)
Interest credited, net of penalties	43,362	52,918	62,834
Total deposits at end of period	\$1,982,881	\$2,052,290	\$2,126,655
Net increase (decrease)	\$(69,409)	\$(74,365)	\$36,215
Percentage increase (decrease)	(3.38%)	(3.50%)	1.73%

At December 31, 2004, we had \$155.1 million in time deposits with balances of \$100,000 and over maturing as follows:

<u>Maturity Period</u>	<u>Amount</u> (In thousands)
Three months or less	\$ 33,011
Over three months through six months	15,146
Over six months through 12 months	28,636
Over 12 months through 24 months	26,690
Over 24 months through 36 months	36,741
Over 36 months	14,893
Total	<u>\$155,117</u>

The following table presents the distribution of our deposit accounts at the dates indicated by dollar amount and percent of portfolio, and the weighted average rate.

	At December 31,								
	2004			2003			2002		
	Amount	Percent of total deposits	Weighted average nominal rate	Amount	Percent of total deposits	Weighted average nominal rate	Amount	Percent of total deposits	Weighted average nominal rate
	(Dollars in thousands)								
Savings	\$ 247,439	12.48%	0.43%	\$240,543	11.72%	0.43%	\$230,170	10.82%	0.63%
Interest-bearing demand	171,565	8.65	0.22	157,231	7.66	0.22	149,008	7.01	0.37
Money market	309,531	15.61	0.97	358,003	17.44	1.05	351,433	16.53	1.62
Non-interest bearing demand	111,855	5.64	0.00	110,099	5.36	0.00	98,941	4.65	0.00
Total	840,390	42.38	0.53	865,876	42.18	0.59	829,552	39.01	0.93
Certificates:									
Time deposits with original maturities of:									
Three months or less	86,259	4.35	1.28	136,756	6.66	1.22	125,771	5.91	2.06
Over three months to twelve months	114,032	5.75	1.45	172,181	8.39	1.48	248,269	11.67	2.53
Over twelve months to twenty-four months	199,174	10.04	2.25	215,428	10.50	2.88	336,919	15.84	3.83
Over twenty-four months to thirty-six months	209,038	10.54	3.12	183,880	8.96	3.75	167,574	7.88	5.12
Over thirty-six months to forty-eight months	204,096	10.29	4.29	202,155	9.85	4.29	188,180	8.85	4.34
Over forty-eight months to sixty months	329,855	16.65	4.84	274,756	13.40	4.98	227,265	10.69	5.31
Over sixty months	37	0.00	7.19	1,258	0.06	6.66	3,125	0.15	5.90
Total time deposits	1,142,491	57.62	3.37	1,186,414	57.82	3.35	1,297,103	60.99	3.91
Total deposits	\$1,982,881	100.00%	2.17%	\$2,052,290	100.00%	2.19%	\$2,126,655	100.00%	2.75%

## Borrowings

We borrow funds to finance our lending and investing activities. Substantially all of our borrowings take the form of advances from the FHLB of Chicago, on terms and conditions generally available to member institutions. At December 31, 2004, we had borrowings totaling \$305.6 million with maturities of less than one year; of the notes payable to the FHLB at year end, \$150.0 million were fixed rate short term borrowings due within 30 days and the balance were overnight borrowings. We have pledged all of our residential mortgage loans and some investment securities as blanket collateral for these advances and future advances. The FHLB of Chicago offers a variety of borrowing options with fixed or variable rates, flexible repayment options, and fixed or callable terms. We choose the rate, repayment option, and term to fit the purpose of the borrowing. See "Notes to Consolidated Financial Statements—Note 7. Borrowings."

The following table sets forth certain information regarding our borrowings at the end of and during the periods indicated:

	At or For the Year Ended December 31,				
	2004	2003	2002	2001	2000
	(Dollars in thousands)				
Balance outstanding at end of year:					
Notes payable to FHLB	\$623,925	\$299,491	\$332,299	\$442,025	\$546,489
Overnight borrowings from FHLB	137,600	--	--	--	20,225
Other borrowings	--	--	22,679	23,335	910
Weighted average interest rate at end of year:					
Notes payable to FHLB	2.89%	5.52%	5.57%	5.75%	6.31%
Overnight borrowings from FHLB	2.47%	--	--	--	6.85%
Other borrowings	--	--	0.99%	1.39%	5.74%
Maximum amount outstanding during the year:					
Notes payable to FHLB	\$623,925	\$332,398	\$445,414	\$547,653	\$546,760
Overnight borrowings from FHLB	289,800	15,000	5,480	29,275	120,900
Other borrowings	--	22,679	19,835	60,720	2,820
Average amount outstanding during the year:					
Notes payable to FHLB	\$325,861	\$318,942	\$395,351	\$491,248	\$289,032
Overnight borrowings from FHLB	75,106	72	25	6,348	20,145
Other borrowings	--	430	3,309	5,285	84
Weighted average interest rate during the year:					
Fixed interest rate notes payable to FHLB	5.23%	5.61%	5.68%	5.91%	6.56%
Overnight borrowings from FHLB	2.03%	1.38%	1.53%	5.74%	6.56%
Other borrowings	--	0.98%	1.45%	3.38%	6.29%

Borrowings increased to \$761.5 million at December 31, 2004, as compared to \$299.5 million at December 31, 2003, primarily to fund the growth in the loan and mortgage-related securities portfolios, a decrease in the deposit portfolio and the repurchase of shares. See "Management's Discussion and Analysis of Financial Condition and Results of Operations-Comparisons of Financial Condition at December 31, 2004 and 2003."

### Average Balance Sheet and Rate Yield Analysis

See "Management's Discussion and Analysis of Financial Condition and Results of Operations-Average Balance Sheet and Yield/Rate Analysis."

### Average Equity to Average Assets

The ratio of average equity to average assets measures a financial institution's financial strength. At December 31, 2004, 2003, 2002, 2001, and 2000 our average equity to average assets ratio was 22.6%, 14.0%, 10.9%, 10.4%, and 9.7%, respectively.

## **Cash Dividends**

We paid cash dividends of \$0.18 per share in 2004, \$0.12 per share in 2003, \$0.093 per share in 2002, and \$0.076 per share in 2001. We did not pay any cash dividends in 2000 because our initial conversion was not completed until late in the year. We increased our quarterly dividend to \$0.06 per share in the first quarter of 2005, from \$0.05 in the fourth quarter of 2004.

## **Subsidiaries**

Lake Financial and Insurance Services, Inc., a wholly owned subsidiary of the Bank, provides investment, brokerage and insurance services to the Bank's customers and the general public. Investment services include tax deferred and tax free investments, mutual funds, and government securities. Personal insurance, business insurance, life and disability insurance and mortgage protection products are also offered by Lake Financial.

Mutual Investment Corporation, a wholly owned subsidiary of the Bank, owns and manages part of the investment portfolio. First Northern Investment Inc. ("FNII"), a wholly owned subsidiary of the Bank, also owns and manages investments and purchases indirect automobile, recreational vehicle and boat loans from our SFC subsidiary.

MC Development LTD, a wholly owned subsidiary of the Bank, is involved in land development and sales. It owns one parcel of undeveloped land consisting of 15 acres in Brown Deer, Wisconsin. In addition, in the third quarter of 2004, MC Development LTD established Arrowood Development, LLC with an independent third party to develop 318 acres in Oconomowoc, Wisconsin. In the initial transaction, the third party purchased approximately one-half interest in that land, all of which previously had been owned by MC Development. It is anticipated that development of the land will begin in the spring of 2005 and that sales of the developed lots will begin in late 2005 or early 2006. See "—Properties."

SFC, 50% owned by the Bank and 50% owned by another financial institution, originates, sells, and services the indirect automobile, recreational vehicles and boat loans. SFC sells the loans on a regular basis to FNII or the Bank, but retains the servicing rights in the loans.

In addition, the Bank has five wholly owned subsidiaries that are inactive but will continue to be wholly owned subsidiaries for possible future use in a related or other area.

## **Employees**

At December 31, 2004, we employed 702 full time and 98 part time associates. Management considers its relations with its associates to be good.



## **Regulation**

Set forth below is a brief description of certain laws and regulations that relate to the regulation of the Bank and the Company.

### **General**

The Bank is a federally chartered stock savings association, chartered as a savings bank, whose primary regulator is the OTS. The FDIC, under the Savings Association Insurance Fund ("SAIF"), insures its deposit accounts up to applicable limits. The Bank is currently subject to extensive regulation, examination and supervision by the OTS as its chartering agency, and by the FDIC as its deposit insurer. The Bank must file reports with the OTS and the FDIC concerning its activities and financial condition, and must obtain regulatory approval prior to entering into certain transactions, such as mergers with, or acquisitions of, other depository institutions and acquiring branch offices. In addition, the Bank's relationship with its depositors and borrowers also is regulated to a great extent by both federal and state laws, especially in such matters as the ownership of deposit accounts and the form and content of the Bank's mortgage documents.

The OTS currently conducts periodic examinations to assess the Bank's compliance with various regulatory requirements. In addition, the FDIC has the right to perform examinations of the Bank should the OTS or the FDIC determine the Bank is in a weakened financial condition or a failure is foreseeable. This regulation and supervision establishes a comprehensive framework of activities in which a savings bank can engage and is intended primarily for the protection of the deposit insurance fund and depositors rather than the shareholders of the Company. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes.

The Company is a Wisconsin corporation registered with the OTS as a unitary savings and loan holding company. It files reports with the OTS and is subject to regulation and examination by the OTS. The Company also is required to file certain reports with, and otherwise comply with, the rules and regulations of the Securities and Exchange Commission under the federal securities laws.

Any change in these laws and regulations, whether by the OTS, the FDIC, the SEC, or through legislation, could have a material adverse impact on the Bank and the Company, and their operations and shareholders.

Certain of the laws and regulations applicable to the Bank and the Company are summarized below. These summaries do not purport to be complete and are qualified in their entirety by reference to such laws and regulations.

### **Federal Regulation of the Bank**

*General.* As a federally chartered, FDIC-insured savings bank, the Bank is subject to extensive regulation by the OTS and the FDIC. Lending activities and other investments must comply with federal statutory and regulatory requirements. This federal regulation and supervision establishes a comprehensive framework of activities in which a savings bank can engage and is intended primarily for the protection of the FDIC and depositors rather than the shareholders of the Company. This regulatory structure gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies regarding the classification of assets and the establishment of adequate loan loss reserves.

The OTS regularly examines the Bank and issues a report on its examination findings to the Bank's board of directors. The Bank's relationships with its depositors and borrowers is also regulated by federal law, especially in such matters as the ownership of savings accounts and the form and content of the Bank's mortgage documents.

The Bank must file reports with the OTS and the FDIC concerning its activities and financial condition, and must obtain regulatory approvals prior to entering into transactions such as mergers with or acquisitions of other financial institutions.

*Regulatory Capital Requirements.* OTS capital regulations require savings associations such as the Bank to meet three capital standards. The minimum standards are tangible capital equal to at least 1.5% of adjusted total assets, core capital equal to at least 3% of adjusted total assets, and risk-based capital equal to at least 8% of total risk-

weighted assets. These capital standards are in addition to the capital standards promulgated by the OTS under its prompt corrective action regulations, as described below under the heading "Prompt Corrective Action."

Tangible capital is defined as core capital less all intangible assets and certain mortgage servicing rights. Core capital is defined as common shareholders' equity, noncumulative perpetual preferred stock, related surplus and minority interests in the equity accounts of fully consolidated subsidiaries, nonwithdrawable accounts and pledged deposits of mutual savings associations and qualifying supervisory goodwill, less nonqualifying intangible assets, mortgage servicing rights and investments in certain non-includable subsidiaries.

The risk-based capital standard for savings institutions requires the maintenance of total risk-based capital of at least 8% of risk-weighted assets. Risk-based capital is comprised of core and supplementary capital. The components of supplementary capital include, among other items, cumulative perpetual preferred stock, perpetual subordinated debt, mandatory convertible subordinated debt, intermediate-term preferred stock, up to 45% of unrealized gains on available-for-sale equity securities with readily determinable fair values, and the portion of the allowance for loan losses not designated for specific loan losses. The portion of the allowance for loan and lease losses includible in supplementary capital is limited to a maximum of 1.25% of risk-weighted assets. Overall, supplementary capital is limited to 100% of core capital. A savings association must calculate its risk-weighted assets by multiplying each asset and off-balance sheet item by various risk factors as determined by the OTS, which range from 0% for cash to 100% for delinquent loans, property acquired through foreclosure, commercial loans, and other assets.

OTS rules require a deduction from capital for institutions that have unacceptable levels of interest rate risk. The OTS calculates the sensitivity of an institution's net portfolio value based on data submitted by the institution in a schedule to its quarterly Thrift Financial Report and using the interest rate risk measurement model adopted by the OTS. The amount of the interest rate risk component, if any, is deducted from an institution's total capital in order to determine if it meets its risk-based capital requirement.

*Dividend and Other Capital Distribution Limitations.* The OTS imposes various restrictions or requirements on the ability of savings associations to make capital distributions, including dividend payments.

OTS regulations require the Bank to give the OTS 30 days' advance notice of any proposed declaration of dividends, and the OTS has the authority under its supervisory powers to prohibit the payment of dividends.

OTS regulations impose uniform limitations on the ability of all savings banks and associations to engage in various distributions of capital such as dividends, stock repurchases and cash-out mergers. In addition, the regulation utilizes a three-tiered approach permitting various levels of distributions based primarily upon a savings bank's capital level.

The Bank currently meets the criteria to be designated a Tier 1 association and, consequently, could at its option (after prior notice to, and no objection made by, the OTS) distribute up to 100% of its net income during the calendar year plus its retained net income for the preceding two years, less any distributions previously paid during the year. Additional dividends or distributions would require further OTS approval.

*Qualified Thrift Lender Test.* Federal savings associations must meet a qualified thrift lender ("QTL") test or they become subject to operating restrictions. The Bank met the QTL test as of December 31, 2004 and anticipates that it will maintain an appropriate level of investments consisting primarily of residential mortgages, mortgage-backed securities and other mortgage-related investments, and otherwise qualify as a qualified thrift lender. The required percentage of these mortgage-related investments is 65% of portfolio assets. Portfolio assets are all assets minus goodwill and other intangible assets, property used by the institution in conducting its business and liquid assets equal to 20% of total assets. Compliance with the qualified thrift lender test is determined on a monthly basis in nine out of every twelve months.

*Liquidity Standard.* Each federal savings association is required to maintain sufficient liquidity to ensure its safe and sound operations.

*Federal Home Loan Bank System.* The Bank is a member of the FHLB of Chicago, which is one of 12 regional Federal Home Loan Banks. Each Federal Home Loan Bank serves as a reserve or central bank for its members within its assigned region. It is funded primarily from funds deposited by member financial institutions and proceeds derived from the sale of consolidated obligations of the Federal Home Loan Bank System. It makes loans to members pursuant to policies and procedures established by the board of directors of the FHLB of Chicago.

As a member, the Bank is required to purchase and maintain stock in the FHLB of Chicago in an amount equal to the greatest of \$500, 1% of its aggregate unpaid residential mortgage loans, home purchase contracts or similar obligations at the beginning of each year, or 5% of its outstanding advances. The Bank is currently in compliance with this requirement. The FHLB of Chicago also imposes various limitations on advances made to member banks, which limitations relate to the amount and type of collateral, the amounts of advances, and other items.

Under the Gramm-Leach-Bliley Financial Services Modernization Act of 1999 (the "GLB Act"), the Bank is a voluntary member of the FHLB of Chicago. The Bank could withdraw or reduce its stock ownership in the FHLB of Chicago, although it has no current intention to do so. The FHLB of Chicago contributes to affordable housing programs through direct loans, interest subsidies on advances, and grants targeted for community investment and low- and moderate-income housing projects. These contributions have adversely affected the level of dividends paid by the FHLB of Chicago and could continue to do so in the future.

*Federal Reserve System.* The Federal Reserve System requires all depository institutions to maintain non-interest-bearing reserves at specified levels against their checking, NOW, and Super NOW checking accounts and non-personal time deposits. Savings institutions have authority to borrow from the Federal Reserve System "discount window," but Federal Reserve System policy generally requires savings institutions to exhaust all other sources before borrowing from the Federal Reserve System.

*Deposit Insurance.* The deposit accounts held by customers of the Bank are insured by the SAIF to a maximum of \$100,000 as permitted by law. Insurance on deposits may be terminated by the FDIC if it finds that the Bank has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC or the OTS as the Bank's primary regulator. The management of the Bank does not know of any practice, condition, or violation that might lead to termination of the Bank's deposit insurance.

The FDIC sets deposit insurance premiums based upon the risks a particular bank or savings association posed to its deposit insurance funds. Under the risk-based deposit insurance assessment system, the FDIC assigns an institution to one of three capital categories based on the institution's financial information, as of the reporting period ending six months before the assessment period. The three capital categories are (1) well capitalized, (2) adequately capitalized and (3) undercapitalized. The FDIC also assigns an institution to one of three supervisory subcategories within each capital group. With respect to the capital ratios, institutions are classified as well capitalized, adequately capitalized or undercapitalized using ratios that are substantially similar to the prompt corrective action capital ratios discussed below. The FDIC also assigns an institution to a supervisory subgroup based on a supervisory evaluation provided to the FDIC by the institution's primary federal regulator and information that the FDIC determines to be relevant to the institution's financial condition and the risk posed to the deposit insurance funds (which may include, if applicable, information provided by the institution's state supervisor).

An institution's assessment rate depends on the capital category and supervisory category to which it is assigned. Under the final risk-based assessment system, there are nine assessment risk classifications (i.e., combinations of capital groups and supervisory subgroups) to which different assessment rates are applied. Assessment rates for deposit insurance currently range from 0 basis points to 27 basis points. The capital and supervisory subgroup to which an institution is assigned by the FDIC is confidential and may not be disclosed. A bank's rate of deposit insurance assessments will depend upon the category and subcategory to which the bank is assigned by the FDIC. Any increase in insurance assessments could have an adverse effect on the earnings of insured institutions, including the Bank.

*Transactions with Affiliates.* Sections 23A and 23B of the Federal Reserve Act govern transactions between an insured federal savings association, such as the Bank, and any of its affiliates, such as the Company. The Federal Reserve Board has adopted Regulation W, which comprehensively implements and interprets Sections 23A and 23B, in part by codifying prior Federal Reserve Board interpretations under Sections 23A and 23B.

An affiliate of a bank is any company or entity that controls, is controlled by or is under common control with the bank. A subsidiary of a bank that is not also a depository institution or a "financial subsidiary" under the GLB Act is not treated as an affiliate of the bank for the purposes of Sections 23A and 23B; however, the OTS has the discretion to treat subsidiaries of a savings association as affiliates on a case-by-case basis. Sections 23A and 23B limit the extent to which a bank or its subsidiaries may engage in "covered transactions" with any one affiliate to an amount equal to 10% of such bank's capital stock and surplus, and limit all such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus. The statutory sections also require that all such transactions be on

terms that are consistent with safe and sound banking practices. The term "covered transaction" includes the making of loans, purchase of assets, issuance of guarantees and other similar types of transactions. Further, most loans by a bank to any of its affiliates must be secured by collateral in amounts ranging from 100 to 130 percent of the loan amounts. In addition, any covered transaction by an association with an affiliate and any purchase of assets or services by an association from an affiliate must be on terms that are substantially the same, or at least as favorable, to the bank as those that would be provided to a non-affiliate.

*Acquisitions and Mergers.* Under the federal Bank Merger Act, any merger of the Bank with or into another institution would require the approval of the OTS, or the primary federal regulator of the resulting entity if it is not an OTS-regulated institution. See also "Acquisition of Bank Mutual Corporation" below for a discussion of factors relating to acquisitions of the Company.

*Prohibitions Against Tying Arrangements.* Savings associations such as the Bank are subject to the prohibitions of 12 U.S.C. Section 1972 on certain tying arrangements. A savings association is prohibited, subject to certain exceptions, from extending credit to or offering any other service, or fixing or varying the consideration for such extension of credit or service, on the condition that the customer obtain some additional service from the institution or certain of its affiliates or not obtain services of a competitor of the institution.

*Customer Privacy.* Savings associations such as the Bank are required to develop and maintain privacy policies relating to information on the customers and establish procedures to protect customer data. Applicable privacy regulations further restrict the sharing of non-public customer data with non-affiliated parties if the customer requests.

*Uniform Real Estate Lending Standards.* The federal banking agencies adopted uniform regulations prescribing standards for extensions of credit that are secured by liens on interests in real estate or made for the purpose of financing the construction of a building or other improvements to real estate. Under the joint regulations adopted by the federal banking agencies, all insured depository institutions must adopt and maintain written policies that establish appropriate limits and standards for extensions of credit that are secured by liens or interests in real estate or are made for the purpose of financing permanent improvements to real estate. These policies must establish loan portfolio diversification standards, prudent underwriting standards (including loan-to-value limits) that are clear and measurable, loan administration procedures, and documentation, approval and reporting requirements. The real estate lending policies must reflect consideration of the Interagency Guidelines for Real Estate Lending Policies that have been adopted by the federal bank regulators.

The Interagency Guidelines, among other things, require a depository institution to establish internal loan-to-value limits for real estate loans that are not in excess of the following supervisory limits:

- for loans secured by raw land, the supervisory loan-to-value limit is 65% of the value of the collateral;
- for land development loans (i.e., loans for the purpose of improving unimproved property prior to the erection of structures), the supervisory limit is 75%;
- for loans for the construction of commercial, multi-family or other non-residential property, the supervisory limit is 80%;
- for loans for the construction of one- to four-family properties, the supervisory limit is 85%; and
- for loans secured by other improved property (e.g., farmland, completed commercial property and other income-producing property, including non-owner occupied, one- to four-family property), the limit is 85%.

Although no supervisory loan-to-value limit has been established for owner-occupied, one- to four-family and home equity loans, the Interagency Guidelines state that for any such loan with a loan-to-value ratio that equals or exceeds 90% at origination, an institution should require appropriate credit enhancement in the form of either mortgage insurance or readily marketable collateral.

*Community Reinvestment Act.* Under the Community Reinvestment Act ("CRA"), any insured depository institution, including the Bank, has a continuing and affirmative obligation consistent with its safe and sound operation to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an

institution's discretion to develop the types of products and services that it believes are best suited to its particular community. The CRA requires the OTS, in connection with its examination of a savings association, to assess the savings association's record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications by such association, including applications for additional branches and acquisitions.

Among other things, the CRA regulations contain an evaluation system that would rate an institution based on its actual performance in meeting community needs. In particular, the evaluation system focuses on three tests:

- a lending test, to evaluate the institution's record of making loans in its service areas;
- affordable housing, and programs benefiting low or moderate income individuals and businesses; and
- a service test, to evaluate the institution's delivery of services through its branches, ATMs and other offices.

The CRA requires the OTS, in the case of the Bank, to provide a written evaluation of a savings association's CRA performance utilizing a four-tiered descriptive rating system and requires public disclosure of an association's CRA rating. The Bank received a "satisfactory" overall rating in its most recent CRA examination.

*Safety and Soundness Standards.* Each federal banking agency, including the OTS, has adopted guidelines establishing general standards relating to internal controls, information and internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, asset quality, earnings and compensation, fees and benefits. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines. The guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director, or principal shareholder.

*Prompt Corrective Action.* FDICIA also established a system of prompt corrective action to resolve the problems of undercapitalized insured institutions. The OTS, as well as the other federal banking regulators, adopted the FDIC's regulations governing the supervisory actions that may be taken against undercapitalized institutions. These regulations establish and define five capital categories, in the absence of a specific capital directive, as follows:

Category	Total Capital to Risk Weighted Assets	Tier 1 Capital to Risk Weighted Assets	Tier 1 Capital to Total Assets
Well capitalized	≥ 10%	≥ 6%	≥ 5%
Adequately capitalized	≥ 8%	≥ 4%	≥ 4%*
Under capitalized	< 8%	< 4%	< 4%*
Significantly undercapitalized	< 6%	< 3%	< 3%
Critically undercapitalized	Tangible assets to capital of < 2%		

\*3% if the bank receives the highest rating under the uniform system

The severity of the action authorized or required to be taken under the prompt corrective action regulations increases as a bank's capital decreases within the three undercapitalized categories. All savings associations are prohibited from paying dividends or other capital distributions or paying management fees to any controlling person if, following such distribution, the association would be undercapitalized. The FDIC or the OTS, in the case of the Bank, is required to monitor closely the condition of an undercapitalized bank and to restrict the growth of its assets. An undercapitalized savings association is required to file a capital restoration plan within 45 days of the date the association receives notice that it is within any of the three undercapitalized categories, and the plan must be guaranteed by any parent holding company. The aggregate liability of a parent holding company is limited to the lesser of:

- an amount equal to five percent of the bank's total assets at the time it became "undercapitalized"; and

- the amount that is necessary (or would have been necessary) to bring the bank into compliance with all capital standards applicable with respect to such bank as of the time it fails to comply with the plan.

If a savings association fails to submit an acceptable plan, it is treated as if it were “significantly undercapitalized.” Banks that are significantly or critically undercapitalized are subject to a wider range of regulatory requirements and restrictions.

The FDIC has a broad range of grounds under which it may appoint a receiver or conservator for an insured savings association. If one or more grounds exist for appointing a conservator or receiver for a savings association, the FDIC may require the association to issue additional debt or stock, sell assets, be acquired by a depository bank or savings association holding company or combine with another depository savings association. Under FDICIA, the FDIC is required to appoint a receiver or a conservator for a critically undercapitalized savings association within 90 days after the association becomes critically undercapitalized or to take such other action that would better achieve the purposes of the prompt corrective action provisions. Such alternative action can be renewed for successive 90-day periods. However, if the savings association continues to be critically undercapitalized on average during the quarter that begins 270 days after it first became critically undercapitalized, a receiver must be appointed, unless the FDIC makes certain findings that the association is viable.

*Loans to Insiders.* A savings association’s loans to its executive officers, directors, any owner of more than 10% of its stock (each, an insider) and any of certain entities affiliated with any such person (an insider’s related interest) are subject to the conditions and limitations imposed by Section 22(h) of the Federal Reserve Act and the Federal Reserve Board’s Regulation O thereunder. Under these restrictions, the aggregate amount of the loans to any insider and the insider’s related interests may not exceed the loans-to-one-borrower limit applicable to national banks, which is comparable to the loans-to-one-borrower limit applicable to the Bank’s loans. All loans by a savings association to all insiders and insiders’ related interests in the aggregate may not exceed the bank’s unimpaired capital and unimpaired surplus. With certain exceptions, loans to an executive officer, other than loans for the education of the officer’s children and certain loans secured by the officer’s residence, may not exceed the greater of \$25,000 or 2.5% of the savings association’s unimpaired capital and unimpaired surplus, but in no event more than \$100,000. Regulation O also requires that any proposed loan to an insider or a related interest of that insider be approved in advance by a majority of the board of directors of the savings association, with any interested director not participating in the voting, if such loan, when aggregated with any existing loans to that insider and the insider’s related interests, would exceed either \$500,000 or the greater of \$25,000 or 5% of the savings association’s unimpaired capital and surplus. Generally, such loans must be made on substantially the same terms as, and follow credit underwriting procedures that are no less stringent than, those that are prevailing at the time for comparable transactions with other persons and must not present more than a normal risk of collectibility.

An exception is made for extensions of credit made pursuant to a benefit or compensation plan of a bank that is widely available to employees of the savings association and that does not give any preference to insiders of the association over other employees of the association.

*The USA PATRIOT Act.* In response to the terrorist attacks of September 11, 2001, Congress adopted the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, or the USA PATRIOT Act. The USA PATRIOT Act gives the federal government new powers to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing, and broadened anti-money laundering requirements. By means of amendments to the Bank Secrecy Act, Title III of the USA PATRIOT Act takes measures intended to encourage information sharing among bank regulatory agencies and law enforcement bodies. Further, certain provisions of Title III impose affirmative obligations on a broad range of financial institutions, including banks and savings associations.

Among other requirements, Title III of the USA PATRIOT Act imposes the following requirements with respect to financial institutions:

- All financial institutions must establish anti-money laundering programs that include, at minimum; (a) internal policies, procedures, and controls; (b) specific designation of an anti-money laundering compliance officer; (c) ongoing employee training programs, and (d) an independent audit function to test the anti-money laundering program.

- The Secretary of the Treasury, in conjunction with other bank regulators, may issue regulations that provide for minimum standards with respect to customer identification at the time new accounts are opened.
- Financial institutions that establish, maintain, or manage private banking accounts or correspondent accounts in the United States for non-United States persons or their representatives (including foreign individuals visiting the United States) must establish appropriate, specific, and, where necessary, enhanced due diligence policies, procedures, and controls designed to detect and report money laundering.
- Financial institutions are prohibited from establishing, maintaining, administering or managing correspondent accounts for foreign shell banks (foreign banks that do not have a physical presence in any country), and will be subject to certain recordkeeping obligations with respect to correspondent accounts of foreign banks.
- Bank regulators are directed to consider a holding company's effectiveness in combating money laundering when ruling on Federal Reserve Act and bank merger applications.

### **Bank Mutual Corporation Regulation**

#### ***Holding Company Regulation***

Bank Mutual Corporation is registered with the Office of Thrift Supervision as a savings and loan holding company and therefore, is subject to regulation and supervision by the OTS. The OTS has enforcement authority over the Company and its non-savings institution subsidiaries. Among other things, this authority permits the OTS to restrict or prohibit activities that are determined to be a risk to the Bank.

Non-grandfathered unitary savings and loan holding companies are limited to those activities permissible for financial holding companies or for multiple savings and loan holding companies. The Company is not a grandfathered unitary savings and loan holding company and, therefore, is limited to the activities permissible for financial holding companies or for multiple savings and loan holding companies. A financial holding company may engage in activities that are financial in nature, including underwriting equity securities and insurance, incidental to financial activities or complementary to a financial activity. A multiple savings and loan holding company is generally limited to activities permissible for bank holding companies under Section 4(c)(8) of the Bank Holding Company Act, subject to the prior approval of the Office of Thrift Supervision, and certain additional activities authorized by OTS regulations.

Federal law prohibits a savings and loan holding company, directly or indirectly, from acquiring control of another savings institution or holding company thereof, without prior written approval of the Office of Thrift Supervision. It also prohibits the acquisition or retention of, with specified exceptions, more than 5% of the equity securities of a company engaged in activities that are not closely related to banking or financial in nature or acquiring or retaining control of an institution that is not federally insured. In evaluating applications by holding companies to acquire savings institutions, the OTS must consider the financial and managerial resources, future prospects of the savings institution involved, the effect of the acquisition on the risk to the insurance fund, the convenience and needs of the community and competitive factors.

#### ***Federal Securities Laws***

Bank Mutual Corporation common stock is registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934. The Company is therefore subject to the information, proxy solicitation, insider trading restrictions and other requirements under the Securities Exchange Act.

**Sarbanes-Oxley Act of 2002.** The Sarbanes-Oxley Act of 2002 was adopted in response to public concerns regarding corporate accountability in connection with the accounting and corporate governance scandals at several prominent companies. The stated goals of the Sarbanes-Oxley Act are to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws.

The Sarbanes-Oxley Act is the most far-reaching U.S. securities legislation enacted in some time. It applies to all public companies, including the Company, that file periodic reports with the SEC, under the Securities Exchange Act.

The Sarbanes-Oxley Act includes very specific additional disclosure requirements and new corporate governance rules, requires the SEC and national securities exchanges and associations to adopt extensive additional disclosure, corporate governance and other related rules and mandates further studies of certain issues by the SEC, and increases penalties for violation. The Sarbanes-Oxley Act represents significant federal involvement in matters traditionally left to state regulatory systems, such as the regulation of the accounting profession, and to state corporate law, such as the relationship between a board of directors and management and between a board of directors and its committees.

The Sarbanes-Oxley Act addresses, among other matters:

- audit committees and auditor independence;
- certification of financial statements by the chief executive officer and the chief financial officer;
- management reporting, and auditor attestation, of internal control over financial reporting;
- the forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer's securities if the issuer's financial statements later require restatement;
- a prohibition on insider trading during retirement plan black out periods;
- further disclosure of off-balance sheet transactions;
- a prohibition on many personal loans to directors and officers (with exceptions for financial institutions);
- expedited filing requirements for reporting of insiders' transactions; and
- disclosure of a code of ethics and disclosure of a change or waiver of such code.

Because some OTS accounting and governance regulations also refer to the SEC's regulations, the Sarbanes-Oxley Act also may affect the Bank.

The Securities and Exchange Commission has been delegated the task of enacting rules to implement various of the provisions with respect to, among other matters, disclosure in filings pursuant to the Exchange Act, which rulemaking is substantially complete.

#### **Acquisition of Bank Mutual Corporation**

Under federal law, no person may acquire control of Bank Mutual Corporation or the Bank without first obtaining, as summarized below, the approval of such acquisition of control by the Office of Thrift Supervision. Under the federal Change in Bank Control Act and the Savings and Loan Holding Company Act, any person, including a company, or group acting in concert, seeking to acquire 10% or more of the outstanding shares of the Company must file a notice with the OTS. In addition, any person or group acting in concert seeking to acquire more than 25% of the outstanding shares of the Company's common stock will be required to obtain the prior approval of the OTS. Under regulations, the OTS generally has 60 days within which to act on such applications, taking into consideration certain factors, including the financial and managerial resources of the acquiror, the convenience and needs of the communities served by the Company and the Bank, and the antitrust effects of the acquisition.

Office of Thrift Supervision conversion regulations prohibit, without the prior written approval of the OTS, any person from making an offer, announcing an intent to make an offer or participating in any other arrangement to purchase stock or acquiring stock in an institution or its holding company from another person, or actually acquiring shares in the converting institution or its holding company, for a period of three years from the date of the completion of the conversion if, upon the completion of such offer, announcement or acquisition, that person would become the beneficial owner of more than 10% of the outstanding stock of the institution or its holding company. The OTS has defined "person" to include any individual, group acting in concert, corporation, partnership,



association, joint stock company, trust, unincorporated organization or similar company, a syndicate or any other group formed for the purpose of acquiring, holding or disposing of securities of an insured institution. However, offers made exclusively to a bank or its holding company, or an underwriter or member of a selling group acting on the converting institution's or its holding company's behalf for resale to the general public are excepted. The Company's conversion was completed on October 29, 2003. The regulation also provides civil penalties for willful violation or assistance in any such violation of the regulation by any person connected with the management of the converting institution or its holding company or who controls more than 10% of the outstanding shares or voting rights of a converted institution or its holding company.

## **Federal and State Taxation**

*Federal Taxation.* The Company and its subsidiaries file a calendar year consolidated federal income tax return, reporting income and expenses using the accrual method of accounting.

*Bad Debt Reserves.* The Small Business Job Protection Act of 1996 (the "Job Protection Act") repealed the "reserve method" of accounting for bad debts by most thrift institutions effective for the taxable years beginning after 1995. Larger thrift institutions such as the Bank are now required to use the "specific charge-off method." The Job Protection Act also granted partial relief from reserve recapture provisions, which are triggered by the change in method. This legislation did not have a material impact on our financial condition or results of operations.

The federal income tax returns for the Company's subsidiaries have been examined and audited or closed without audit by the IRS for tax years through 1999.

Depending on the composition of its items of income and expense, the Company may be subject to alternative minimum tax ("AMT") to the extent AMT exceeds the regular tax liability. AMT is calculated at 20% of alternative minimum taxable income ("AMTI"). AMTI equals regular taxable income increased by certain tax preferences, including depreciation deductions in excess of allowable AMT amounts, certain tax-exempt interest income and 75% of the excess of adjusted current earnings ("ACE") over AMTI. ACE equals AMTI adjusted for certain items, primarily accelerated depreciation and tax-exempt interest. The payment of AMT would create a tax credit, which can be carried forward indefinitely to reduce the regular tax liability in future years.

*State Taxation.* Under current law, the state of Wisconsin imposes a corporate franchise tax of 7.9% on the separate taxable incomes of the members of our consolidated income tax group except our Nevada subsidiaries. Presently, the income of the Nevada subsidiaries is only subject to taxation in Nevada, which currently does not impose a corporate income or franchise tax. However, see "Management's Discussion and Analysis of Financial Condition—Comparisons of Operating Results for the Years Ended December 31, 2004 and 2003—Income Taxes" for a discussion of Wisconsin tax developments relating to these subsidiaries.

## Item 2. Properties

The Company and its subsidiaries conducts its business through its executive office, an operations center and 71 banking offices, which had an aggregate net book value of \$39.9 million as of December 31, 2004. The following table shows the location of our offices, whether they are owned or leased, and the expiration date of the leases for the leased offices.

Location	Original Date Leased or Acquired	Leased or Owned*	Location	Original Date Leased or Acquired	Leased or Owned*
<b>Executive Office:</b>					
4949 West Brown Deer Road Brown Deer, WI 53223	1991	Owned			
<b>Southeast Region:</b>					
<b>Milwaukee Metro Area:</b>					
Bayshore Mall 5900 N. Port Washington Road Glendale, WI 53217	1971	Leased (2009)	Brookfield 17100 W. Capitol Drive Brookfield, WI 53005	1973**	Owned
Brookfield Square 400 N. Moorland Road Brookfield, WI 53005	1975	Leased (2006)	Brown Deer 4801 W. Brown Deer Road Brown Deer, WI 53223	1979	Owned
Capitol Drive 8050 W. Capitol Drive Milwaukee, WI 53222	1976	Owned	Cedarburg W62 N248 Washington Avenue Cedarburg, WI 53012	1978**	Leased (2006)
Downtown 510 E. Wisconsin Avenue Milwaukee, WI 53202	1955	Owned	Grafton 2030 Wisconsin Avenue Grafton, WI 53024	1978	Owned
Howell Avenue 3847 S. Howell Avenue Milwaukee, WI 53207	1977	Owned	Mayfair Mall 2600 N. Mayfair Road Wauwatosa, WI 53226	2001	Leased (2011)
Menomonee Falls W178 N9379 Water Tower Place Menomonee Falls, WI 53051	2003	Owned	Mequon 11249 N. Port Washington Road Mequon, WI 53092	1970**	Owned
Oak Creek 8780 S. Howell Avenue Oak Creek, WI 53154	1972	Owned	Oklahoma Avenue 6801 W. Oklahoma Avenue Milwaukee, WI 53219	1982	Owned
Sherman Park 4812 W. Burleigh Street Milwaukee, WI 53210	1950**	Owned	Southgate 3340 S. 27th Street Milwaukee, WI 53215	1967	Owned
Southridge Mall 5300 S. 76th Street Greendale, WI 53129	1978	Leased (2006)	Thiensville 208 N. Main Street Thiensville, WI 53092	1960**	Owned
West Allis 10296 W. National Avenue West Allis, WI 53227	1976	Owned	Racine 5133 Douglas Ave. Racine, WI 53402	Opening in 2005	Owned
<b>Madison Area:</b>					
Downtown 23 S. Pinckney Street Madison, WI 53703	1980	Leased (2008)	West 5521 Odana Road Madison, WI 53719	1982	Leased (2011)
Middleton 6209 Century Avenue Middleton, WI 53562	1978	Owned	Monona 5320 Monona Drive Monona, WI 53716	1981	Owned
<b>Sheboygan Area:</b>					
Sheboygan 801 N. 8th Street Sheboygan, WI 53081	1973	Owned	Sheboygan Motor Bank 730 N. 9th Street Sheboygan, WI 53081	1984	Owned

Location	Original Date Leased or Acquired	Leased Or Owned	Location	Original Date Leased or Acquired	Leased or Owned
<b>Additional Southeast Locations:</b>					
<b>Beaver Dam:</b> 130 W. Maple Avenue Beaver Dam, WI 53916	1975	Owned	<b>Beloit:</b> 3 Beloit Mall Shopping Center Beloit, WI 53511	1971	Leased (2012)
<b>Berlin:</b> 103 E. Huron Street Berlin, WI 54923	1973	Owned	<b>Fond du Lac:</b> W6606A Highway 23 Fond du Lac, WI 54937	2000	Owned
<b>Janesville:</b> 2111 Holiday Drive Janesville, WI 53545	1973	Owned	<b>Portage:</b> 145 E. Cook Street Portage, WI 53901	1976	Owned
<b>Northeast Region:</b>					
<b>Greater Green Bay Area:</b> 201 N. Monroe Avenue Green Bay, WI 54301-4995	1975**	Owned	2255 University Avenue Green Bay, WI 54308-8046	1970**	Owned
2357 S. Oneida Street Green Bay, WI 54304-5286	1971**	Owned	2603 Glendale Avenue Green Bay, WI 54313-6823	1986**	Owned
2370 East Mason Street Green Bay, WI 54302-3347	1985**	Owned	2424 West Mason Street Green Bay, WI 54303-4711	1992**	Owned
749 Main Avenue De Pere, WI 54115-5190	1972**	Owned	330 North Broadway De Pere, WI 54115-5250	1979**	Owned
201 West Walnut St. (Operations Center) Green Bay, WI 54303	1999**	Leased (2009)			
<b>Fox Valley Area:</b> Appleton 4323 W. Wisconsin Avenue Fox River Mall Appleton, WI 54915	1985	Leased (2009)	<b>Neenah</b> 101 W. Wisconsin Avenue Neenah, WI 54956	1974	Owned
<b>Marinette Area:</b> 830 Pierce Avenue Marinette, WI 54143-0318	1972**	Owned	<b>Pine Tree Mall</b> 2314 Roosevelt Road Marinette, WI 54143-0345	1978**	Leased (2006)
<b>Brillion:</b> 314 N. Main Street Brillion, WI 54110-1198	1973**	Owned	<b>Crivitz:</b> 315 Highway 141 Crivitz, WI 54114-0340	1985**	Owned
<b>Hortonville:</b> 209 South Nash Street Hortonville, WI 54944	1979**	Owned	<b>Kiel:</b> 622 Fremont Street Kiel, WI 53042-1321	1970**	Owned
<b>New Holstein:</b> 2205 Wisconsin Avenue New Holstein, WI 53061-1291	1976**	Owned	<b>New London:</b> 101 Park Street New London, WI 54961	1969**	Owned
<b>Peshigo:</b> 616 French Street Peshigo, WI 54157-0193	1975**	Owned	<b>Shawano:</b> 835 E. Green Bay Avenue Shawano, WI 54166-0396	1981**	Owned
<b>Sturgeon Bay:</b> 1227 Egg Harbor Road Sturgeon Bay, WI 54235-0068	1978**	Owned			

Location	Original Date Leased or Acquired	Leased Or Owned*	Location	Original Date Leased or Acquired	Leased Or Owned*
<b>Northwest Region:</b>					
<b>Eau Claire:</b> Downtown 319 E. Grand Avenue Eau Claire, WI 54701	1968**	Owned	Mall 2812 Mall Drive Eau Claire, WI 54701	1972**	Owned
Cub Foods 2717 Birch Street Eau Claire, WI 54703	1996**	Leased (2010)	Pinehurst 2722 Eddy Lane Eau Claire, WI 54703	1986**	Owned
<b>Chippewa Falls Area:</b> Downtown 35 W. Columbia Chippewa Falls, WI 54729	1975**	Owned	Falls Pick'N Save 303 Prairie View Road Chippewa Falls, WI 54729	1995**	Leased (2010)
<b>Menomonie Area:</b> Downtown 717 Main Street Menomonie, WI 54751	1967**	Owned	North 2409 Hills Ct. N.E Menomonie, WI 54751	1978**	Owned
<b>Barron:</b> 1512 E. Division Ave. (Hwy. 8) Barron, WI 54812	1995**	Owned	<b>Bloomer:</b> 1203 17th Avenue Bloomer, WI 54724	1995**	Owned
<b>Cornell:</b> 422 Main Street Cornell, WI 54732	1980**	Leased (month to month)	<b>Ellsworth:</b> 385 W. Main Street Ellsworth, WI 54011	1975**	Owned
<b>Hayward:</b> 10562 Kansas Avenue Hayward, WI 54843	1984**	Owned	<b>Hudson:</b> 2000 Crestview Drive Hudson, WI 54016	1979**	Owned
<b>Rice Lake:</b> 2850 Pioneer Avenue Rice Lake, WI 54868	1979**	Owned	<b>Spooner:</b> 500 Front Street Spooner, WI 54801	1995**	Owned
<b>St. Croix Falls:</b> 144 Washington Street N St. Croix Falls, WI 54024	1980**	Owned	<b>Stanley:</b> 118 N. Broadway Stanley, WI 54768	1978**	Owned
<b>Woodbury, Minnesota:</b> 8420 City Centre Drive Woodbury, MN 55125	1995**	Owned			

\* If a leased property, the chart also shows year of lease expiration.

\*\* Date originally opened by an institution which was acquired by the Bank.

In addition, the Bank owns one parcel of undeveloped land in Brown Deer, Wisconsin through its MC Development subsidiary and one parcel of undeveloped land in Oconomowoc, Wisconsin. The 15 acre Brown Deer parcel is comprised of four lots consisting of 2.9 to 4.3 acres and was part of a larger property that was acquired in 1988 to accommodate the construction of a new corporate headquarters building. Each of the lots is available for sale and is designed to accommodate 60,000 to 75,000 square foot office buildings. The net book value of the four lots is \$1.6 million.

MC Development's owned Oconomowoc property consists of 318 acres of undeveloped land of which a one-half interest was sold in 2004 to a third party. Simultaneously in 2004, MC Development and that third party formed a joint venture, Arrowhead Development, LLC, to develop the entire 318 acre site. We anticipate that Arrowhead Development will begin to develop this land in 2005, and that residential lot sales will begin by late 2005 or in 2006.

### **Item 3. Legal Proceedings**

The Bank is not involved in any pending legal proceedings other than routine legal proceedings occurring in the ordinary course of business. We believe that these routine legal proceedings, in the aggregate, are immaterial to our financial condition and results of operations.

### **Item 4. Submission of Matters to a Vote of Security Holders**

Not applicable.

### **Executive Officers of the Registrant**

The table below sets forth certain information regarding the persons who have been determined, by our board of directors, to be executive officers of the Company. These persons will continue in the same positions with the successor the Company.

<b><u>Name and Age</u></b>	<b><u>Offices and Positions with Bank Mutual Corporation and the Bank*</u></b>	<b><u>Executive Officer Since (1)</u></b>
Michael T. Crowley, Jr., 62	Chairman, President and Chief Executive Officer of Bank Mutual Corporation; President and Chief Executive Officer of the Bank (2)	1968
Eugene H. Maurer, Jr., 59	Senior Vice President and Secretary of Bank Mutual Corporation; Senior Vice President, Chief Financial Officer, Treasurer and Secretary of the Bank	1982
Rick B. Colberg, 52	Chief Financial Officer of Bank Mutual Corporation; Vice President of the Bank (3)	1980
Marlene M. Scholz, 59	Senior Vice President and principal accounting officer of Bank Mutual Corporation; Senior Vice President and Controller of the Bank	1981
P. Terry Anderegg, 54	Senior Vice President—Retail Operations of the Bank (4)	1993
Christopher J. Callen, 61	Senior Vice President—Lending of the Bank (4)	1998

\* Excluding directorships and excluding positions with Bank subsidiaries. Those positions do not constitute a substantial part of the officers' duties.

- (1) Indicates date when individual first held an executive officer position with the Bank or First Northern Savings. Each of these persons, other than Mr. Anderegg and Mr. Callen, became a Bank Mutual Corporation executive officer in 2000.
- (2) Michael Crowley, Jr. became president of Bank Mutual Corporation in 2003.
- (3) Rick Colberg is the chief financial officer of Bank Mutual Corporation. He is also Vice President of the Bank since 2003, when First Northern Savings merged into it. Previously he was senior vice president, chief financial officer, and treasurer of First Northern Savings.
- (4) This position has been considered to be an executive officer position of Bank Mutual Corporation since May 2003, as a result of the merger of the subsidiary banks.

## Part II

### **Item 5. Market for Registrant's Common Equity and Related Stockholder Matters and Issuer Purchase of Equity Securities**

The common stock of the Company is traded on The Nasdaq Stock Market® under the symbol "BKMU."

As of February 28, 2005, there were 68,964,713 shares of common stock outstanding and approximately 6,423 shareholders of record. Bank Mutual Corporation became a publicly held corporation on November 1, 2000 and we did not pay a cash dividend in 2000. We paid a cash dividend of \$0.18 per share in 2004. We increased our cash dividend to \$0.06 per share to shareholders of record on February 17, 2005 which was paid March 1, 2005.

We anticipate that we will continue to pay quarterly cash dividends on our common stock, although there can be no assurance that payment of such dividends will continue or that they will not be reduced. The payment of dividends in the future is discretionary with our board of directors and will depend on our operating results and financial condition, regulatory limitations, tax considerations and other factors.

Interest on deposits will be paid prior to payment of dividends on Bank Mutual Corporation's common stock. Earnings appropriated to bad debt reserves and deducted for federal income tax purposes cannot be used to pay cash dividends without the payment of federal income taxes on the amounts removed from the reserves for such purpose at the then current income tax rate.

Our common stock trades on The Nasdaq Stock Market®. The high and low trading prices from January 1, 2002 through December 31, 2004, by quarter, and the dividends paid in each quarter, were as follows:

#### **COMMON STOCK TRADING PRICE RANGE (High and Low Sales Price)**

	<b>2004</b>		<b>2003*</b>		<b>2002*</b>	
	<b>High</b>	<b>Low</b>	<b>High</b>	<b>Low</b>	<b>High</b>	<b>Low</b>
1 <sup>st</sup> Quarter	\$11.55	\$10.90	\$ 6.937	\$ 6.259	\$4.770	\$4.151
2 <sup>nd</sup> Quarter	\$11.35	\$ 9.65	\$ 9.625	\$ 8.723	\$5.681	\$4.634
3 <sup>rd</sup> Quarter	\$12.40	\$10.50	\$11.846	\$10.075	\$5.931	\$4.784
4 <sup>th</sup> Quarter	\$12.59	\$11.80	\$12.600	\$11.000	\$6.951	\$5.469

#### **CASH DIVIDENDS PAID**

	<b>2004</b>	<b>2003*</b>	<b>2002*</b>
1 <sup>st</sup> Quarter	\$0.040	\$0.027	\$0.022
2 <sup>nd</sup> Quarter	\$0.040	0.027	0.022
3 <sup>rd</sup> Quarter	\$0.050	0.030	0.025
4 <sup>th</sup> Quarter	\$0.050	0.035	0.025
	<u>\$0.180</u>	<u>\$0.120</u>	<u>\$0.093</u>

\* Trading prices and per share cash dividends have been rounded and reflect the October 2003 exchange of 3.6686 shares of Bank Mutual Corporation for every share of the "old" Bank Mutual Corporation.

A cash dividend of \$0.06 per share, a 20.0% increase over the fourth quarter of 2004 cash dividend of \$0.05 per share, was paid on March 1, 2005 to shareholders of record on February 17, 2005.

During the first two months of 2005, Bank Mutual's common stock sales price ranged between \$12.30 to \$11.50 per share, and closed on February 28, 2005 at \$12.09 per share

During 2004, Bank Mutual Corporation repurchased 6,642,521 shares at an average price of \$11.87 per share. In addition, in December 2004, we announced another stock repurchase program, for 5.0 million shares; we did not begin purchases under this program until January 2005. In February 2005, we announced an amendment to this plan to increase the total number of shares to be repurchased under it to 10.0 million. As of February 28, 2005 Bank Mutual Corporation has repurchased 4.5 million shares at an average price of \$12.17 per share.

The following table provides the specified information about the repurchases of shares by the Company during the fourth quarter of 2004.

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum number of shares that may be purchased under the recent plans or programs*
October 1 to 31, 2004	-	\$ -	-	-
November 1 to 30, 2004	3,879,344	12.28	3,878,000	1,122,000
December 1 to 31, 2004	1,123,930	12.29	1,122,000	5,000,000
Total	5,003,274	\$ 12.28	5,000,000	

\* At period end.

The above table does not reflect the February 2005 amendment of the previously-announced stock repurchase plan to permit repurchase of an additional 5.0 million shares. The shares not purchased as part of the publicly announced program were existing owned Company shares used by option holders in payment of the purchase price and/or tax withholding obligations in connection with their exercise of stock options under the Company's 2001 Stock Incentive Plan. The "price" used for these purposes is the deemed value of those shares under the 2001 Plan.

## **Item 6. Selected Financial Data**

### **Selected Financial Highlights**

The following table provides selected financial data for Bank Mutual Corporation for its past five fiscal years. The data is derived from the Company's audited financial statements, although the table itself is not audited. The following data should be read together with the Company's consolidated financial statements and related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations" later in this report.

On November 1, 2000, Mutual Savings Bank converted from a mutual to stock form of organization, completing a restructuring that resulted in the creation of Bank Mutual Corporation as its publicly-held holding company. The transactions included the Company's stock offering and the Company's related acquisition of First Northern. Under the purchase accounting method, First Northern's results are included from the date of acquisition, and results prior to those dates are those of Mutual Savings Bank.

On October 29, 2003, the Company completed a conversion and reorganization from a mutual holding company form, established a new Wisconsin chartered company and in effect sold the MHC's investment in the Company to the public. Approximately \$404.8 million of net new capital was obtained in the October 29, 2003 conversion.

	At December 31,				
	2004	2003	2002	2001	2000
(In thousands except number of shares and per share amounts)					
<b>Selected Financial Condition Data:</b>					
Total assets	\$3,445,299	\$3,108,527	\$2,843,328	\$2,905,790	\$2,789,532
Loans receivable, net	1,875,885	1,712,278	1,685,662	1,831,155	1,972,636
Loans held for sale	4,987	4,056	46,971	32,321	7,469
Securities available-for-sale, at fair value:					
Investment securities	68,753	67,854	73,226	93,059	94,129
Mortgage-related securities	1,266,224	1,053,349	618,123	521,084	464,873
Foreclosed properties and repossessed assets	1,621	630	750	382	2,281
Goodwill	52,570	52,570	52,570	52,570	55,967
Other intangible assets	4,412	5,073	5,734	6,396	7,057
Mortgage servicing rights	4,542	4,698	3,060	4,251	3,442
Deposits	1,982,881	2,052,290	2,126,655	2,090,440	1,894,820
Borrowings	761,525	299,491	354,978	465,360	567,624
Shareholders' equity	670,454	731,080	323,075	304,098	284,397
Tangible shareholders' equity	610,698	670,771	264,011	243,486	220,757
Number of shares outstanding – net of treasury stock <sup>(1)</sup>	73,485,113	78,775,779	79,802,950	81,946,124	81,962,632
Book value per share <sup>(1)</sup>	9.12	9.28	4.05	3.71	3.47
Tangible book value per share <sup>(1)</sup>	8.31	8.51	3.31	2.97	2.69



For the Year Ended December 31,					
	2004	2003	2002	2001	2000
(In thousands except per share amount)					
<b>Selected Operating Data:</b>					
Total interest income	\$148,921	\$141,070	\$165,432	\$190,986	\$135,711
Total interest expense	58,498	69,482	87,678	119,372	84,980
Net interest income	90,423	71,588	77,754	71,614	50,731
Provision for loan losses	1,330	1,304	760	723	423
Net interest income after provision for loan losses	89,093	70,284	76,994	70,891	50,308
Total noninterest income	16,175	19,618	16,676	16,480	9,250
Noninterest expense:					
Amortization of goodwill	—	—	—	3,098	1,066
Amortization of other intangible assets	661	661	662	662	331
Total noninterest expense	60,082	55,608	54,169	55,004	36,144
Income before income taxes	45,186	34,294	39,501	32,367	23,414
Income tax expense	15,632	11,695	12,956	12,084	8,709
Net income	\$29,554	\$22,599	\$26,545	\$20,283	\$14,705
Earnings per share-basic <sup>(1)</sup>	\$0.39	\$0.30	\$0.34	\$0.26	\$0.04 <sup>(2)</sup>
Earnings per share-diluted <sup>(1)</sup>	\$0.38	\$0.29	\$0.34	\$0.26	\$0.04 <sup>(2)</sup>
Cash dividends paid per share <sup>(1)</sup>	\$0.18	\$0.12	\$0.093	\$0.076	n/a
<b>At or for the Year Ended December 31,</b>					
	2004	2003	2002	2001	2000
<b>Selected Financial Ratios:</b>					
Net interest margin <sup>(3)</sup>	3.00%	2.58%	2.88%	2.67%	2.76%
Net interest rate spread	2.44	2.17	2.52	2.22	2.26
Return on average assets	0.93	0.76	0.92	0.71	0.76
Return on assets, excluding amortization of goodwill <sup>(4)</sup>	0.93	0.76	0.92	0.82	0.82
Return on average shareholders' equity	4.10	5.45	8.44	6.85	7.86
Return on average shareholders' equity excluding amortization of goodwill <sup>(4)</sup>	4.10	5.45	8.44	7.89	8.43
Efficiency ratio, excluding amortization of goodwill <sup>(4)(5)</sup>	56.36	60.97	57.36	58.92	58.48
Noninterest expense (excluding amortization of goodwill) as a percent of adjusted average assets <sup>(4)</sup>	1.88	1.88	1.88	1.82	1.82
Shareholders' equity to total assets	19.46	23.52	11.36	10.47	10.20
Tangible shareholders' equity to adjusted total assets <sup>(6)</sup>	18.04	22.01	9.48	8.57	8.11
<b>Selected Asset Quality Ratios:</b>					
Non-performing loans to loans receivable, net	0.33%	0.61%	0.50%	0.19%	0.16%
Non-performing assets to total assets	0.23	0.35	0.32	0.14	0.19
Allowance for loan losses to non-performing loans	222.09	132.77	151.87	345.90	392.12
Allowance for loan losses to non-performing assets	176.46	125.17	139.40	312.13	226.55
Allowance for loan losses to total loans receivable, net	0.74	0.80	0.76	0.67	0.62
Charge-offs to average loans	0.07	0.02	0.01	0.04	0.01

(1) Per share and share information prior to October 29, 2003 has been adjusted to reflect the full conversion transaction and related 3.6686-for-one share exchange on that date.

(2) From date of restructuring (November 1, 2000) to December 31, 2000 based upon 79,134,648 weighted-average shares outstanding. No shares were outstanding prior to November 1, 2000.

(3) Net interest margin is calculated by dividing net interest income by average earnings assets.

- (4) In 2002, accounting rules concerning the amortization of goodwill changed. These ratios are being presented "excluding goodwill" so as to make them comparable among the years presented.
- (5) Efficiency ratio is calculated by dividing noninterest expense by the sum of net interest income and noninterest income.
- (6) The ratio is calculated by dividing total shareholders' equity minus goodwill, other intangible assets net of deferred taxes and mortgage servicing rights by the sum of total assets minus goodwill, other intangible assets net of deferred taxes and mortgage servicing rights.

## **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

### **Overview**

From November 1, 2000 until October 29, 2003, Bank Mutual Corporation was an OTS chartered United States corporation which became the mid-tier holding company in the regulatory restructuring of Mutual Savings Bank into mutual holding company form. Until October 29, 2003, Bank Mutual Bancorp, MHC (the "MHC"), a U.S.-chartered mutual holding company of which Mutual Savings Bank's depositors held all of the voting and membership rights, owned 52.2% of Bank Mutual Corporation's outstanding common stock.

On November 1, 2000, Bank Mutual Corporation also acquired First Northern Capital Corp., the parent of First Northern Savings Bank. On March 16, 2003, Mutual Savings Bank and First Northern Savings Bank combined to form a single OTS chartered savings bank subsidiary of Bank Mutual Corporation called "Bank Mutual" herein called (the "Bank").

On October 29, 2003, Bank Mutual Corporation completed a conversion and reorganization from a mutual holding company form, established a new Wisconsin chartered Bank Mutual Corporation and, in effect, sold the MHC's interest in Bank Mutual Corporation to the public. Existing Bank Mutual Corporation shareholders exchanged each existing share for 3.6686 shares of the new Bank Mutual Corporation shares. The total number of shares issued or exchanged in the offering was approximately 78,707,669 shares.

All share and per share numbers in this discussion have been adjusted to reflect the full conversion transaction and related share exchange. As used herein, the "Company" and "Bank Mutual Corporation" refer to Bank Mutual Corporation both before and after the full conversion transaction, unless the context requires otherwise.

### **Significant Accounting Policies**

There are a number of accounting policies that we established which require us to use our judgment. Some of the more significant policies are as follows:

- Establishing the amount of the allowance for loan losses requires the use of our judgment. The allowance for loan losses is maintained at a level believed adequate by management to absorb probable losses inherent in the loan portfolio and is based on the size and current risk characteristics of the loan portfolio, an assessment of individual problem loans and actual loss experience, current economic events in specific industries and geographical areas, including unemployment levels, and other pertinent factors, including regulatory guidance and general economic conditions. Determination of the allowance is inherently subjective as it requires significant estimates, including the amounts and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends, all of which may be susceptible to significant change. Loan losses are charged off against the allowance, while recoveries of amounts previously charged off are credited to the allowance. A provision for loan losses is charged to operations based on management's periodic evaluation of the factors previously mentioned, as well as other pertinent factors. Evaluations are conducted at least quarterly and more often if deemed necessary. If we misjudge a major component and experience a loss, it will likely affect our earnings. Developments affecting loans can also cause the allowance to vary significantly between quarters. We consistently challenge ourselves in the review of the risk components to identify any changes in trends and their cause.
- Another valuation that requires our judgment relates to mortgage servicing rights. Mortgage servicing rights are recorded as an asset when loans are sold with servicing rights retained. The total cost of loans sold is allocated between the loan balance and the servicing asset based on their relative fair values. The capitalized value of mortgage servicing rights is amortized in proportion to, and over the period of, estimated net future servicing revenue. Mortgage servicing rights are carried at the lower of the initial carrying value, adjusted for amortization, or estimated fair value. The carrying values are periodically evaluated for impairment. For purposes of measuring impairment, the servicing rights are stratified into pools based on term and interest rate. Impairment represents the excess of the remaining capitalized cost of a stratified pool over its fair value, and is recorded through a valuation allowance. The fair value of each servicing rights pool is calculated based on the present value of estimated future cash flows using a discount rate, given current market conditions. Estimates of fair value include assumptions about prepayment speeds, interest rates and other factors which are subject to change over time. Changes in these underlying assumptions could cause

the fair value of mortgage servicing rights, and the related valuation allowance, if any, to change significantly in the future.

- We also use our judgment in the valuation of other intangible assets (core deposit base intangibles). Core deposit base intangible assets have been recorded for core deposits (defined as checking, money market and savings deposits) that have been acquired in acquisitions that were accounted for as purchase business combinations. The core deposit base intangible assets have been recorded using the assumption that they provide a more favorable source of funding than more expensive wholesale borrowings. An intangible asset has been recorded for the present value of the difference between the expected interest to be incurred on these deposits and interest expense that would be expected if these deposits were replaced by wholesale borrowings, over the expected lives of the core deposits. We currently estimate the underlying core deposits have lives of seven to fifteen years. If we find these deposits have a shorter life, we will have to write down the asset by expensing the amount that is impaired.
- We review goodwill at least annually for impairment, which requires the use of our judgment. Goodwill has been recorded as a result of two acquisitions in which the purchase price exceeded the fair value of tangible net assets acquired. If goodwill is determined to be impaired, it would be expensed in the period in which it became impaired.
- The assessment of our tax assets and liabilities involves the use of estimates, assumptions, interpretations, and judgments concerning certain accounting pronouncements and federal and state tax codes. There can be no assurance that future events, such as court decisions, regulatory actions or interpretations, or changes in positions of federal and state taxing authorities will not differ from management's current assessment. The impact of these matters could be significant to the consolidated results of operations and reported earnings.

### **Comparisons of Financial Condition at December 31, 2004 and 2003**

Bank Mutual Corporation's total assets at December 31, 2004, were \$3.45 billion as compared to \$3.11 billion at December 31, 2003. Total assets increased \$336.8 million or 10.8% primarily as a result of investment of \$200.0 million into mortgage-related securities funded by borrowing.

Cash and cash equivalents decreased \$48.9 million in 2004 primarily as a result of using federal funds sold and interest-earning deposits to purchase mortgage-related securities, fund loans and deposit outflows.

Investment securities available-for-sale increased \$899,000 during 2004 as a result of the increased fair market value in 2004.

Mortgage-related securities available-for-sale increased \$212.9 million in 2004 primarily as a result of the reinvestment of principle and interest payments received from the mortgage-related securities portfolio and \$200.0 million of mortgage-related securities purchased as a result of the additional borrowings. We intend to use the repayments and prepayments on these securities to fund loans and, therefore, reduce the dollar amount of the mortgage-related securities portfolio over time. The current portfolio has a weighted average yield of approximately 4.31% at December 31, 2004; however, the average yield earned for the year on the average portfolio was 4.35% as compared to 4.38% for the year of 2003. At December 31, 2004, we had \$9.9 million of private placement collateralized mortgage obligations ("CMOs") in our investment portfolio. Private placement CMOs have more credit risk than government agency CMOs and therefore, have a higher risk of impairment. If permanent impairment would occur, a related impairment would reduce earnings. See "Item 1. Business – Investment Activities."

The following table sets forth our mortgage, consumer and commercial loan originations and purchases:

	During the year ended December 31,	
	2004	2003
	(In thousands)	
Originations:		
Mortgage loans	\$479,814	\$ 899,766
Consumer loans	268,521	301,665
Commercial business loans	41,018	49,646
Total loans originated	789,353	1,251,077
Purchases:		
Mortgage loans	148,951	41,214
Total loans purchased	148,951	41,214
Total loans originated and purchased	\$938,304	\$1,292,291

Loan originations decreased \$461.7 million in 2004 as compared to originations in 2003, primarily as a result of relatively stable interest rates which prompted consumers to reduce the refinancing of their existing loans. Mortgage loan originations decreased \$420.0 million or 46.7% and consumer loans decreased \$33.1 million or 11.0% in 2004 as a result of the reduced refinancing of existing loans. A majority of the consumer loan originations continued to be first and second mortgage loans. We significantly increased our purchases of mortgage loans during 2004 to augment our loan originations. Each mortgage loan that is purchased is underwritten by us and conforms to our underwriting standards. Most of these purchased mortgage loans are in Wisconsin or in states adjacent to Wisconsin.

Commercial business loan originations decreased \$8.6 million or 17.4 % in 2004 primarily as a result of reduced demand for commercial loans in our market area. In 2004, we hired an additional four experienced commercial loan originators in our continued efforts to emphasize commercial loan originations. Most of the new commercial loan originators were hired in the last six months of 2004. We anticipate that we will continue our emphasis not only on commercial loans but also on consumer loan originations to aid our asset and liability management and to aid in our overall profitability, although at somewhat more risk than traditional mortgage products.

Loans held for sale at December 31, 2004 as compared to December 31, 2003 increased \$931,000 as a result of a temporary decrease in market interest rates in the fourth quarter of 2004, which resulted in more fixed rate mortgage loan originations and ultimately sales of fixed rate mortgage loans. Currently, we sell all of our 30 year fixed rate mortgage loan originations and some of our 20 and 15 year fixed rate mortgage loan originations in the secondary mortgage market.

Loans receivable increased \$163.6 million in 2004 as a result of growth in all loan products except commercial real estate and commercial business loans. The one-to four-family mortgage loan portfolio increased \$110.3 million or 13.9% primarily as a result of reduced fixed rate mortgage loan sales, reduced refinancing of existing loans, increased mortgage loans purchases from third parties and increased adjustable interest rate mortgage loan originations which are retained in the portfolio. The multi-family portfolio increased \$37.1 million or 29.8% and the consumer loan portfolio increased \$26.8 million or 5.9% both primarily as a result of reduced payoffs of existing loans.

The commercial real estate portfolio decreased \$13.6 million or 6.5% primarily as a result of payoffs of related loans made to finance large apartment complexes. These loans were refinanced by the borrower with another company. The commercial business loan portfolio decreased \$4.9 million or 6.5% primarily as a result of reduced originations and the transfer of \$3.1 million of commercial non-performing loans to real estate owned and repossessed assets and ultimate disposal of the collateral or write-off of the loans.

Management expects to continue to emphasize consumer, non-residential mortgage loan and commercial business loan originations, as we believe they will continue to add to the overall profitability and aid in the management of interest rate risk. However, these loans can present higher credit risks than residential mortgage loans.

Goodwill resulted from the acquisitions of First Northern in 2000 and First Federal Bancshares of Eau Claire ("First Federal") in 1997. Under the Financial Accounting Standards Board ("FASB") Statement No. 142 "Goodwill and Other Intangible Assets" goodwill is tested at least annually for impairment. If goodwill is determined to be impaired, it will be expensed in the period in which it became impaired. No impairment of goodwill occurred in 2004, 2003 or 2002.

Other intangible assets are composed of core deposit base intangibles which were also the result of the First Northern and First Federal Eau Claire acquisitions. Other intangible assets are amortized over their expected life and tested for impairment at least annually.

Mortgage servicing rights are established on mortgage loans that we originate and sell. See "—Significant Accounting Policies" above and "—Comparisons of Operating Results for Years Ended December 31, 2004 and 2003—Noninterest Income" below for a further discussion of mortgage servicing rights.

Other assets are comprised of the following:

	At December 31,	
	2004	2003
	(In thousands)	
Accrued Interest:		
Mortgage-related securities	\$ 4,581	\$ 4,034
Investment securities	172	200
Loans receivable	6,599	6,586
Total accrued interest	11,352	10,820
Foreclosed properties and repossessed assets	1,621	630
Premises and equipment	43,966	45,196
Federal Home Loan Bank stock, at cost	38,186	35,498
Bank owned life insurance	19,324	18,268
Other	15,902	11,734
	<u>\$130,351</u>	<u>\$122,146</u>

Our foreclosed properties and repossessed assets increased \$991,000 to \$1.6 million at December 31, 2004 as a result of foreclosures on commercial business loans. We believe that we continue to have good asset quality, particularly in our residential portfolio, and the homes, boats, recreational vehicles and other items that have been repossessed, are small in dollar amount in comparison to the size of our loan portfolio.

Premises and equipment decreased \$1.2 million in 2004 primarily as a result of normal depreciation of these assets. We anticipate that two or three new bank office buildings will be established in 2005. The effect of these new bank offices will be an increase to our premises and equipment depreciation expense.

Federal Home Loan Bank ("FHLB") of Chicago stock increased \$2.7 million primarily as a result of stock dividends paid by the FHLB of Chicago. The FHLB of Chicago requires that its members own FHLB of Chicago stock as a condition for borrowing. The FHLB of Chicago generally pays dividends and had targeted a rate of return for their stock of 1% over the 1 year constant maturity Treasury note yield. Recently, the FHLB of Chicago modified its dividend payout policy to a dividend payout ratio not to exceed 90% of its adjusted core income, which is net income excluding gains or losses from non-recurring events. Historically, the FHLB of Chicago stock has met or exceeded its targeted returns but we cannot assure that will continue. See "Notes to Consolidated Financial Statements—Note 7. Borrowings."

Bank owned life insurance ("BOLI") is an asset that is used to partially offset the future cost of employee benefits. BOLI is long-term life insurance on the lives of certain current and past employees where the insurance policy benefits and ownership are retained by us. We value BOLI at the amount which we could obtain if we cashed in the policies at the current time. The cash value accumulation on BOLI is permanently tax deferred if the policy is held to the insured person's death.

Deposits decreased \$69.4 million in 2004 primarily as a result of our decision to offer interest rates on longer-term deposits at interest rates that approximate market average interest rates rather than offering higher promotional deposit rates. We believe that deposit growth (or shrinkage) for future periods will continue to depend, in a significant part, on the performance of other investment alternatives and world events. Early in 2005, we contracted with a wholesale deposit program which has the potential to increase the amount of our wholesale deposits.

Our borrowings increased \$462.0 million in 2004, as a result of the increase in the securities and loan portfolio, the decrease in the deposit portfolio and the repurchase of our shares. In 2004, we refinanced two Federal Home Loan Bank of Chicago borrowings totaling \$200.0 million that had maturities in November and December of 2004. The refinanced borrowings are due in September 2006. Prior to refinancing, the interest rates on the borrowings were 5.62% and 5.77% while, the new two year FHLB borrowing has a fixed interest rate of 2.75%. As a result of this transaction, we paid a \$1.7 million prepayment penalty. In addition, in the fourth quarter of 2004, we borrowed an additional \$200.0 million from the FHLB, on customary terms offered by the FHLB to member institutions. In addition to the foregoing borrowings, we also had outstanding overnight borrowings of \$137.6 million at December 31, 2004 and \$150.0 million of short-term fixed rate borrowing which matured early in January 2005 and was refinanced on similar short-term basis; these additional borrowings also were on terms and conditions which the FHLB generally makes available to member institutions. We use overnight and short-term borrowings to fund loan originations and decreases in deposits on a shorter-term basis.

Shareholders equity decreased \$60.6 million in 2004 primarily as a result of the repurchase of shares, dividends paid in 2004, a decrease in our accumulated other comprehensive income and an increase in unearned deferred compensation offset by our net earnings.

We repurchased 6,642,521 shares in 2004 at an average price of \$11.87. In addition, on December 19, 2004, we announced another 5.0 million Share Repurchase Plan that began January 21, 2005. On February 21, 2005, our existing repurchase plan was modified by authorizing an additional 5.0 million shares (a total of 10.0 million shares) to be repurchased. In 2005, through February 28th, we have repurchased an additional 4,524,000 shares, at an average price of \$12.17 per share.

We increased our quarterly cash dividend to \$0.04 per share for the first and second quarter of 2004, and again increased our cash dividend to \$0.05 per share for the third and fourth quarter of 2004. The dividend payout ratio for 2004 was 45.3%, and total dividends paid during the year were \$13.4 million. In February 2005, we further increased our dividend to \$0.06 per share; our total dividends paid will not increase proportionately, however, as a result of our share repurchases.

Accumulated other comprehensive income decreased \$5.0 million in 2004 primarily as a result of unfunded supplemental non-qualified benefit plan obligation and reduced fair market value on the mortgage-related securities. Accumulated other comprehensive income reflects the difference between the net current value of securities available for sale and the book value of those securities, net of tax, and any unfunded supplemental non-qualified benefit plan obligation, net of tax.

After the shareholders approved the 2004 Stock Incentive Plan, restricted shares were issued which increased unearned deferred compensation. Our shareholders equity to total assets ratio at December 31, 2004 was 19.5% as compared to 23.5% at December 31, 2003.

## Average Balance Sheet and Yield/Rate Analysis

The following tables present, for the periods indicated, the total dollar amount of interest income from average interest-earning assets, the resultant yields, and the interest expense on average interest-bearing liabilities, expressed both in dollars and rates. No tax equivalent adjustments were made since we do not have any tax exempt investments. Average balances are derived from average daily balances. The yield on securities available-for-sale is included in investment securities and mortgage-related securities and yields are calculated on the historical basis. The yields and rates are established by dividing income or expense dollars by the average balance of the asset or liability.

### AVERAGE BALANCE SHEET, INTEREST AND RATE PAID

	Years ended December 31,								
	2004			2003			2002		
	Average Balance	Interest Earned/ Paid	Average Yield/ Cost	Average Balance	Interest Earned/ Paid	Average Yield/ Cost	Average Balance	Interest Earned/ Paid	Average Yield/ Cost
(Dollars in thousands)									
<b>Assets:</b>									
<b>Interest-Earning Assets (1):</b>									
Loans receivable, net	\$1,799,670	\$97,330	5.41%	\$1,739,572	\$104,623	6.01%	\$1,808,861	\$124,490	6.88%
Mortgage-related securities	1,090,363	47,431	4.35	665,804	29,164	4.38	576,259	32,256	5.60
Investment securities (2)	104,681	3,956	3.78	116,097	4,654	4.01	120,015	5,580	4.65
Interest-earning deposits	11,834	128	1.08	47,491	423	0.89	27,991	431	1.54
Federal funds	5,546	76	1.37	205,671	2,206	1.07	162,137	2,675	1.65
Total interest-earning assets	3,012,094	148,921	4.95	2,774,635	141,070	5.08	2,695,263	165,432	6.14
Noninterest-earning assets	175,491			185,530			179,081		
Total average assets	<u>\$3,187,585</u>			<u>\$2,960,165</u>			<u>\$2,874,344</u>		
<b>Liabilities and Equity:</b>									
<b>Interest-Bearing Liabilities:</b>									
Savings deposits	\$253,321	1,084	0.43	\$293,735	1,490	0.51	\$229,303	2,402	1.05
Money market accounts	335,553	3,301	0.98	347,901	4,353	1.25	349,868	6,673	1.91
Interest-bearing demand accounts	164,588	359	0.22	143,331	416	0.29	141,328	833	0.59
Time deposits	1,139,368	37,373	3.28	1,261,281	45,160	3.58	1,281,258	54,983	4.29
Total deposits	1,892,830	42,117	2.23	2,046,248	51,419	2.51	2,001,757	64,891	3.24
Advance payment by borrowers for taxes and insurance	19,759	36	0.18	19,205	88	0.46	21,401	243	1.14
Borrowings	414,600	16,345	3.94	319,348	17,975	5.63	398,684	22,544	5.65
Total interest-bearing liabilities	2,327,189	58,498	2.51	2,384,801	69,482	2.91	2,421,842	87,678	3.62
<b>Noninterest-Bearing Liabilities</b>									
Noninterest-bearing deposits	106,224			111,955			92,988		
Other noninterest-bearing liabilities	33,638			48,481			44,836		
Total noninterest-bearing liabilities	139,862			160,436			137,824		
Total liabilities	2,467,051			2,545,237			2,559,666		
Equity	720,534			414,928			314,678		
Total average liabilities and equity	<u>\$3,187,585</u>			<u>\$2,960,165</u>			<u>\$2,874,344</u>		
Net interest income and net interest rate spread (3)		<u>\$90,423</u>	2.44		<u>\$71,588</u>	2.17		<u>\$77,754</u>	2.52
Net interest-earning assets and net interest margin(4)	<u>\$ 684,905</u>		3.00%	<u>\$ 389,834</u>		2.58%	<u>\$ 273,421</u>		2.88%
Average interest-earnings assets to average interest-bearing liabilities	1.29x			1.16x			1.11x		

- (1) For the purposes of these computations, non-accruing loans and loans held for sale are included in the average loans outstanding.
- (2) FHLB stock is included in investment securities dollars outstanding and yields.
- (3) Interest rate spread is the difference between the average yield on interest-earning assets and the average cost on interest-bearing liabilities.
- (4) Net interest margin is determined by dividing net interest income by total interest-earning assets.



## Rate/Volume Analysis

The following table presents the extent to which changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities have affected our interest income and interest expense during the periods indicated. Information is provided in each category with respect to:

- (1) changes attributable to changes in volume (change in volume multiplied by prior rate);
- (2) changes attributable to change in rate (changes in rate multiplied by prior volume); and
- (3) the net change.

The changes attributable to the combined impact of volume and rate have been allocated proportionately to the changes due to volume and the changes due to rate.

	Year Ended December 31, 2004 Compared to 2003		
	Increase (Decrease) Due To		
	Volume (1)	Rate (2)	Net (3)
	(In thousands)		
<b>Interest-earning assets:</b>			
Loans receivable	\$ 3,519	\$(10,812)	\$ (7,293)
Mortgage-related securities	18,470	(203)	18,267
Investment securities	(442)	(256)	(698)
Interest-earning deposits	(370)	75	(295)
Federal funds	(2,607)	477	(2,130)
Total	18,570	(10,719)	7,851
<b>Interest-bearing liabilities:</b>			
Savings deposits	(191)	(215)	(406)
Money market deposits	(149)	(903)	(1,052)
Interest-bearing demand deposits	56	(113)	(57)
Time deposits	(4,168)	(3,619)	(7,787)
Advance payment by borrowers for taxes and insurance	3	(55)	(52)
Borrowings	4,561	(6,191)	(1,630)
Total	112	(11,096)	(10,984)
Net change in net interest income	\$18,458	\$ 377	\$ 18,835

	Year Ended December 31, 2003 Compared to 2002		
	Increase (Decrease) Due To		
	Volume (1)	Rate (2)	Net (3)
	(In thousands)		
<b>Interest-earning assets:</b>			
Loans receivable	\$(4,627)	\$(15,240)	\$(19,867)
Mortgage-related securities	4,560	(7,652)	(3,092)
Investment securities	(177)	(749)	(926)
Interest-earning deposits	221	(229)	(8)
Federal funds	609	(1,078)	(469)
Total	586	(24,948)	(24,362)
<b>Interest-bearing liabilities:</b>			
Savings deposits	554	(1,466)	(912)
Money market deposits	(38)	(2,282)	(2,320)
Interest-bearing demand deposits	12	(429)	(417)
Time deposits	(845)	(8,978)	(9,823)
Advance payment by borrowers for taxes and insurance	(23)	(132)	(155)
Borrowings	(4,466)	(103)	(4,569)
Total	(4,806)	(13,390)	(18,196)
Net change in net interest income	\$ 5,392	\$(11,558)	\$ (6,166)

## **Comparisons of Operating Results for Years Ended December 31, 2004 and 2003**

### **General**

Net income was \$29.6 million for 2004 as compared to \$22.6 million for 2003. The increase is primarily the result of investing the \$404.8 million of net capital received from our stock offering in October 2003, which resulted in increases in interest income and the net interest margin, and from a \$2.0 million gain on sale of real estate. These items were partially offset by reduction in the gains on the sales of loans, payment of a borrowing prepayment penalty, and increases in operating expenses.

### **Net Interest Income**

Net interest income for 2004 increased \$18.8 million, or 26.3% to \$90.4 million as compared to \$71.6 million for 2003. Net interest income increased primarily as a result of the investment of the \$404.8 million of net stock proceeds and as a result of the investment of the proceeds, an increased net interest margin. The net interest margin for 2004 was 3.00% as compared to 2.58% for 2003.

The increase in the net interest margin for 2004 was primarily the result of investing the \$404.8 million of net capital received from the stock offering (the capital bears no interest) in late 2003. The increase in the dollar amount of interest earning assets was also the result of the investment of the capital received from the Company's stock offering. Most of the capital received was invested in mortgage-related securities. Going forward, since the effect of the increased capital was reflected for all of 2004, we do not expect to achieve a similar effect in 2005.

### **Total Interest Income**

Total interest income for 2004 increased \$7.9 million or 5.6%, to \$148.9 million as compared to \$141.1 million for 2003. The increase was primarily the result of the increased dollar amount of mortgage-related securities partially offset by the decrease in the yields earned on the loan portfolio.

Interest income on loans decreased \$7.3 million or 7.0% to \$97.3 million as compared to \$104.6 million in 2003. The decrease was primarily the result of the reduced average yield earned on the portfolio partially offset by an increase in the average dollar amount of the loan portfolio outstanding. Market interest rates on most loan originations throughout 2004 were below the existing yield on the loan portfolio and a large number of payoffs were on loans that were in excess of the average yield of loans in our loan portfolio. These events reduced our average yield on the loan to 5.41% in 2004 as compared to 6.01% in 2003.

Interest income on investment securities decreased \$698,000 or 15.0% primarily as a result of reduced average dollar amount outstanding and reduced yield on those investments.

Interest income on mortgage-related securities increased \$18.3 million or 62.6% as a result of investing the \$404.8 million of net stock proceeds in late 2003 and additional borrowings in 2004 into mortgage-related securities. All of the funds were invested in mortgage-related securities with initial average lives of 3 to 4 years and at a yield of approximately 4.50%.

Interest income on interest-earning deposits (which includes federal funds sold) decreased \$2.4 million or 92.2% as a result of reduced dollars outstanding partially offset by an increase in average yield on those deposits. The federal funds sold and interest-earning deposits at December 31, 2003 were reinvested into mortgage-related securities.

### **Interest Expense**

Interest expense on deposits decreased \$9.3 million or 18.1% as a result of decreased average cost of deposits and decreased dollar amount of deposits. The average cost of deposits for 2004 was 2.23% as compared to 2.51% in 2003. The decrease in the cost of deposits was the result of relatively flat market interest rates and our efforts to price deposits closer to the median of the market rather than at the higher end of the market offerings. However, as a result of this pricing decision, our deposit portfolio decreased throughout 2004.

Interest expense on borrowings decreased \$1.6 million or 9.1% as a result of the reduced average cost of borrowings partially offset by an increase in the dollar amount of average borrowings. Average borrowings in 2004 increased \$95.3 million and at December 31, 2004, borrowings were \$462.0 million higher than at December 31, 2003. We used the proceeds of these borrowings as well as our existing capital resources, to fund an increase in the loan portfolio, an increase in mortgage-related securities, a decrease in the deposit portfolio and repurchases of our

shares. In the fourth quarter of 2004, we borrowed \$200.0 million from the FHLB of Chicago at a cost of 2.77% and reinvested those funds into mortgage-related securities. The average cost of borrowings in 2004 was 3.94% as compared to 5.63% in 2003. The decrease in the average cost was the result of the new borrowings being added at a cost that was less than the average cost of borrowings and the refinancing of \$200.0 million in September of 2004. The refinanced \$200.0 million of borrowings had an average cost of 5.70% and were refinanced at an interest rate of 2.75%. As a result of prepaying the \$200.0 million of FHLB borrowing, we paid a prepayment penalty of \$1.7 million. The prepayment of the FHLB borrowings was done as a result of management anticipating a rise in interest rates at the time the original FHLB borrowings matured and its desire to lock in relatively lower interest rates, which should favorably affect related interest expense going forward; the prepayment fees were more than offset by interest savings. The balance of our borrowings at December 31, 2004 were overnight funds or fixed rate short term borrowings.

### **Provision for Loan Losses**

Provisions for loan losses in 2004 and 2003 were \$1.3 million. The \$1.3 million in the provisions for loan losses for 2004 was primarily determined as a result of charge-offs of loans totaling \$1.3 million. The charge-offs in 2004 were primarily attributed to one commercial loan that was placed in real estate owned and subsequently liquidated. In addition, there is one large commercial loan, of approximately \$3.2 million that was non-performing at December 31, 2004 that we are closely monitoring and working with the business owners in an effort to arrange repayment.

The dollar amount of the typical commercial real estate, development and commercial loan tends to be larger than our single family loans and, therefore, any loss that we experience on these loans could be larger than what we have historically experienced on our single family loans. Depending on the type of commercial loan, the collateral may appeal only to a specialized group of people or businesses and therefore, may limit the number of potential buyers of the collateral, or in the case of collateral that is comprised of inventory, the liquidation of the collateral is more uncertain if a problem should arise.

The allowance for loan losses at December 31, 2004 was \$13.9 million or 222.1% of non-performing loans and 176.5% of non-performing assets as compared to \$13.8 million or 132.8% of non-performing loans and 125.2% of non-performing assets at December 31, 2003. The loan loss allowance to total loans was 0.74% at December 31, 2004 as compared to 0.80% at December 31, 2003.

Future provisions for loan losses will continue to be based upon our assessment of the overall loan portfolio and the underlying collateral, trends in non-performing loans, current economic conditions and other relevant factors in order to maintain the allowance for loan losses at adequate levels to provide for probable and estimatable losses. The establishment of the amount of the loan loss allowance inherently involves judgments by management as to the adequacy of the allowance, which ultimately may or may not be correct. Higher rates of loan defaults than anticipated would likely result in a need to increase provisions in future years. Also, as multi-family and commercial loan portfolios increase, additional provisions would likely be added to the loan loss allowances as they carry a higher risk of loss. See also "Asset Quality" in Item 1, which is incorporated by reference, for certain other factors that may affect our provisions for loan losses on a go forward basis.

### **Noninterest Income**

Total noninterest income decreased \$3.4 million or 17.6% to \$16.2 million as compared to \$19.6 million for 2003. The decrease was primarily the result of decreased dollar amount of loan sales which correspondently decreased the gains on sales of loans.

Service charges on deposits decreased \$184,000 in 2004 primarily as a result of the decreased number of deposit accounts and customer utilization of on-line banking and credit cards. We believe the reduced number of checking accounts is the result of our change in the checking account pricing policy in 2003.

Brokerage and insurance commissions increased \$348,000 or 13.8% as a result of increased annuity and insurance sales.

Loan related fees and servicing revenue increased \$954,000 or 150.0% in 2004 primarily as a result of \$1.4 million of mortgage loan servicing rights becoming impaired in 2003, which offset related income in that year. In 2004, there were no impairments to the mortgage servicing rights. Mortgage servicing rights normally become impaired

from increased prepayments on mortgage loans which reduces the anticipated servicing fee income over the life of the loan.

Gains on sales of loans decreased substantially in 2004 as a result of reduced dollar amount of loan sales. Loan sales in 2004 were \$120.5 million as compared to \$461.1 million in 2003.

In the third quarter of 2004, we sold one-half of our interest in approximately 318 acres of owned real estate to an unrelated third party; the transaction resulted in a \$2.0 million gain. We simultaneously established a limited liability company (Arrowood Development) with that party, in which we maintain a 50% interest, to develop the land. It is anticipated that the development of the real estate into a residential subdivision and subsequent sale of the developed lots will be a two-to four-year project.

Other income increased \$37,000 or 0.8% in 2004 primarily as the result of increased ATM and checkcard fees.

#### **Noninterest Expense**

Compensation expense increased \$4.5 million or 14.1% to \$36.2 million in 2004 as compared to \$31.7 million in 2003. The increase was primarily the result of reduced compensation and benefit cost deferrals on loan originations, vesting of restricted shares from the 2001 and 2004 Stock Incentive Plans and increased cost of benefits which included retirement and health expenses. Each loan that is originated has an incremental compensation and benefit cost determined and as loan originations decrease the incremental compensation and benefit cost deferrals decrease. In 2004, as a result of reduced refinancings of existing loans, the compensation and benefit cost deferrals decreased \$2.2 million as compared to 2003.

At the 2004 Annual Meeting, shareholders approved a 2004 Stock Incentive Plan which authorized 4,106,362 stock options and 1,642,521 shares for a management recognition plan ("MRP" or "restricted stock"). In May 2004, 955,000 shares of restricted stock was granted to various officers. This grant and the fair market valuation of ESOP shares increased compensation expense approximately \$1.8 million in 2004 as compared to 2003. Health insurance and pension costs increased a \$1.1 million primarily as a result of increased health insurance premiums and decreased rates of return on pension investments.

Occupancy and equipment expense remained fairly constant when compared to 2003 primarily as a result of not adding any new offices in 2004. However, in 2005, we anticipate adding two new branch offices (in the Racine area) and one new office in the Waukesha area. The net effect of adding these new offices will be to increase our occupancy and equipment expense and other operating expenses in 2005.

Other expenses increased slightly in 2004 as compared to 2003. However, within the other expenses, marketing costs decreased \$234,000 primarily as a result of the non-recurring expenses associated with the merger of our two subsidiary banks in March 2003. This marketing expense decrease was offset by increases in real estate owned expense associated with the disposal of a large commercial loan and increased auditing costs associated with the internal control attestation required as part of the implementation of Sarbanes-Oxley Act Section 404.

#### **Income Taxes**

The effective tax rate for 2004 was 34.6%, as compared to an effective tax rate of 34.1% in 2003.

Bank owned life insurance income is permanently tax deferred if the policy is held to the participant's death. Therefore, the income earned on the life insurance is not included in taxable income for the calculation of tax expense.

Like many Wisconsin financial institutions, we have non-Wisconsin subsidiaries which hold and manage investment assets, the income on which has not been subject to Wisconsin tax. The Wisconsin Department of Revenue has instituted an audit program specifically aimed at out of state bank subsidiaries. The Department has asserted the position that some or all of the income of the out of state subsidiaries is taxable in Wisconsin. The Department is conducting audits of many such organizations, including our Nevada subsidiaries; its audit of Bank Mutual and its Nevada subsidiaries has not yet been concluded, and the Department has not asserted a claim against the Bank or its subsidiaries.

The Department sent letters in late July 2004 to Wisconsin financial institutions (whether or not they were undergoing an audit) reporting on settlements relating to these issues involving, at that time, 17 financial institutions

and their out-of-state investment subsidiaries. The letter provided a summary of available settlement parameters. For prior periods they include: restrictions on the types of subsidiary income excluded from Wisconsin taxation; assessment of certain back taxes relating to a limited time period; limitations on net operating loss carry forwards and interest on past-due taxes (but no penalties). For 2004 and going forward, the letter states similar provisions, including limits on subsidiaries' assets which could be considered in determining income not subject to Wisconsin taxation. As outlined, the settlement would result in the rescission of prior letter rulings, and purport to be binding going forward except for future legislation or change by mutual agreement. However, the letter appears to implicitly accept the general proposition that some out-of-state investment subsidiary income is not subject to Wisconsin taxes. The Department's positions may be challenged by one or more financial institution in the state.

The Company has engaged in discussions with the Department and has advised the Department that it wishes to receive and consider a proposal from the Department. In particular, the Company asked the Department to consider some specific factors which the Company believes may distinguish it from many other institutions. We have received certain information from the Department to further evaluate its position and our alternatives under our particular circumstances. The Company believes that it will need more specific detail than was included in the Department's July letter or subsequent communications to quantify in any definitive way the Department's view of its exposure, either for past periods or with respect to operations going forward, and to evaluate the Company's alternatives. A determination on how to proceed will depend in part on further communication from and actions by the Department.

Depending upon the terms and circumstances, an adverse resolution of these matters could result in additional Wisconsin tax obligations for prior periods and/or higher Wisconsin taxes going forward, with a substantial negative impact on the earnings of Bank Mutual Corporation. The Company believes it has reported income and paid Wisconsin taxes in accordance with applicable legal requirements, and the Department's long standing interpretations thereof. We also may incur further costs in the future to address these issues.

## **Comparisons of Operating Results for Years Ended December 31, 2003 and 2002**

### **General**

Net income was \$22.6 million for 2003 as compared to \$26.5 million for 2002. The decrease is primarily the result of decreased net interest margin and increases in the provisions for loan losses and operating expenses. These items were partially offset by an increase in the gains on the sale of loans.

### **Net Interest Income**

Net interest income for 2003 decreased \$6.2 million, or 7.9%, to \$71.6 million as compared to \$77.8 million for 2002. Net interest income decreased primarily as a result of a decrease in the net interest margin. The net interest margin for 2003 was 2.58% as compared to 2.88% for 2002. Although market interest rates for loans and deposits remained fairly stable throughout 2003, the high level of loan refinancing activity, in which higher interest rate loans were paid off, downward interest rate modifications on existing loans and the sales of fixed rate mortgage loans decreased the yield on the loan portfolio more than the decrease in the cost of funds.

### **Total Interest Income**

Total interest income for 2003 decreased \$24.4 million, or 14.7%, to \$141.1 million as compared to \$165.4 million for 2002. The decrease was primarily the result of: existing loans being refinanced to lower interest rate loans; sales of fixed rate mortgage loans in which the proceeds were invested in lower yielding mortgage-related securities; and prepayments of higher yielding mortgage-related securities.

Interest income on loans decreased \$19.9 million, or 16.0% in 2003 to \$104.6 million as compared to \$124.5 million in 2002. The decrease was primarily the result of refinancing of existing loans to lower interest rate loans, loan originations that were at interest rates below the existing yield on the portfolio, downward interest rate modifications on certain existing loans and reduced average dollars outstanding for the year. Although 2003 was the second consecutive year of record originations, it was also a record year of loan sales. We sell our 30 year and some of our 20 and 15 year fixed rate mortgage loan originations to help us manage interest rate risk. All of these events reduced the average yield on our loan portfolio to 6.01% for 2003 as compared to 6.88% for 2002.

Interest income on investment securities decreased \$926,000 or 16.6% primarily as a result of reduced dollars invested and a reduced yield on those investments. As investments matured the proceeds were either reinvested into an investment at a lower yield or invested into mortgage-related securities.

Interest income on mortgage-related securities decreased \$3.1 million or 9.6%, as a result of higher yielding mortgage-related securities being prepaid and the reinvestment of those dollars into mortgage-related securities that were below the existing yield on the portfolio. In addition, we invested \$329.3 million of the \$404.8 million of proceeds from the stock offering by the end of November of 2003 and \$74.9 million in December of 2003.

Interest income on interest earning deposits (which includes federal funds sold) decreased \$477,000 or 15.3%, primarily as a result of the decreased yield earned on the deposits. The average balance of interest-earning deposits increased \$63.0 million in 2003 to \$253.2 million as compared to \$190.1 million in 2002. The weighted average yield on interest-earning deposits for 2003 was 1.04% as compared to 1.63% for 2002.

### **Interest Expense**

Interest expense on deposits decreased \$13.5 million or 20.8% as a result of decreased costs of deposits. The average cost of deposits decreased to 2.51% in 2003 from 3.24% in 2002 primarily as a result of market interest rates trending lower throughout 2003 and the mix of the types of deposits. Savings deposits increased whereas, the higher cost time deposits decreased. We purposely reduced the offering interest rates on some of our time deposit products to decrease our cost of funds and to limit the growth. Although the cost of deposits decreased throughout 2003, and our policy to be somewhat less aggressive in pricing our deposit products as a result of our liquidity position, it did not decrease as much as the yield on interest-earning assets, therefore, our net interest margin was compressed.

Interest expense on borrowings decreased \$4.6 million or 20.3%, as a result of less borrowings outstanding for 2003. Average borrowings outstanding for 2003 was \$319.3 million as compared to \$398.7 million for 2002.

### **Provisions for Loan Losses**

Provisions for loan losses in 2003 were \$1.3 million as compared to \$760,000 for 2002. The increase in the provision for loan losses was primarily the result of increased commercial business loan delinquencies and, to a lesser extent, a change in the loan portfolio composition. We have two commercial borrowers with loans totaling \$6.5 million that became non-performing in 2003. Both commercial borrowers have experienced reduced sales for their products and are experiencing operating losses. One commercial borrower, with an aggregate of \$3.3 million in loans, had been current in its loan payments until the fourth quarter of 2003 in which it became delinquent. The other borrower with an aggregate of \$3.2 million in loans, has also experienced reduced sales however, they are delinquent in their payments.

The dollar amount of the typical commercial real estate, development and commercial loan tends to be larger than our single family loans and, therefore, any loss that we experience on these loans could be larger than what we have historically experienced on our single family loans. Depending on the type of commercial loan, the collateral may appeal only to a specialized group of people or businesses and therefore, may limit the number of potential buyers of the collateral, or in the case of collateral that is comprised of inventory, the liquidation of the collateral is more uncertain if a problem should arise.

The allowance for loan losses at December 31, 2003 was \$13.8 million or 132.8% of non-performing loans and 125.2% of non-performing assets as compared to \$12.7 million or 151.9% of non-performing loans and 139.4% of non-performing assets at December 31, 2002. The loan loss allowance to total loans was 0.80% at December 31, 2003 as compared to 0.76% at December 31, 2002.

### **Noninterest Income**

Total noninterest income increased \$2.9 million or 17.6% to \$19.6 million for 2003 as compared to \$16.7 million for 2002. The increase is primarily the result of increased gains on the sales of loans and the reduction of the valuation allowance for mortgage servicing rights.

Service charges on deposits increased \$180,000 in 2003 as a result of increased number of accounts which pay service fees (normally checking accounts) and a pricing increase in which deposit fees were increased.

Brokerage and insurance commissions decreased \$630,000 in 2003 primarily as a result of decreased securities and fixed rate tax deferred annuity sales.

Loan related fees and servicing revenues increased \$1.7 million in 2003 as a result of reducing the valuation allowance for mortgage servicing rights. In 2002 and early 2003, mortgage servicing rights were determined to be temporarily impaired; therefore, servicing revenue was decreased and a valuation allowance was established to reflect the proper value. As loan refinancings decreased thereby reducing principal prepayments, the mortgage servicing rights increased in value. At that point, the entire valuation allowance was reduced, the effect of which is reflected in the increased loan related fees and servicing revenues.

Gains on the sale of investment increased \$112,000 as a result of a sale of an investment.

Gains on the sales of loans increased \$862,000 as a result of increased dollar amount of loans sold. We sold \$461.1 million of fixed rate mortgage loans in 2003 as compared to \$368.6 million in 2002. Gains on the sales of loans are primarily dependent on the dollar amount of fixed rate mortgage loan originations and the sale of those loans. If interest rates remain flat or increase, these gains could be reduced in future periods as sales are likely to decrease (as experienced in the fourth quarter of 2003).

Other noninterest income increased \$726,000 in 2003 primarily as a result of an increase in debit card fees and income on assets held in a rabbi trust.

## **Noninterest Expense**

Total noninterest expense increased \$1.4 million primarily as a result of a modest increase in compensation and related expenses; an increase in costs associated with updating our data processing equipment and software; and an increase in costs associated with opening a new office and replacing an existing office.

Compensation, payroll taxes, and other employee benefit expense increased \$397,000 or 1.3% as a result of compensation and benefit increases partially offset by a \$275,000 recapture of a self funded health plan reserve.

Occupancy and equipment expense increased \$338,000 as a result of deploying upgraded teller PCs, purchasing new teller software throughout our bank office network in 2002, and the construction of a new bank office and a replacement bank office in the later part of 2003.

Other expenses increased \$705,000 primarily as a result of increased marketing expenses, costs associated with the consolidation of the two subsidiary banks and a branding campaign for the resulting bank, and ATM and electronic banking fees.

## **Income Taxes**

The effective tax rate for 2003 was 34.1%, as compared to an effective tax rate of 32.8% in 2002.



## **Liquidity and Capital Resources**

The term "liquidity" refers to our ability to generate adequate amounts of cash to fund loan originations, loan purchases, deposit withdrawals, and operating expenses. Our primary sources of funds are deposits, scheduled amortization, and prepayments of loan principal and mortgage-related securities, maturities and calls of investment securities, borrowings from the FHLB of Chicago and funds provided by our operations. Historically, these sources of funds have been adequate to maintain liquidity, with more borrowing in periods in which their operations generate less cash. In the event these sources of liquidity would become inadequate, Bank Mutual believes that it could access the wholesale deposit market, although there can be no assurances that wholesale deposits would be available if needed. During 2004, we substantially increased our levels of FHLB borrowings, in part to take advantage of what we believe were favorable borrowing opportunities and in part to fund growth without the need to grow deposits by offering above-market promotional interest rates.

Loan repayments and maturing investment securities are a relatively predictable source of funds. However, deposit flows, calls of investment securities and prepayments of loans and mortgage-related securities are strongly influenced by interest rates, general and local economic conditions and competition in the marketplace. For example, during 2004, loan prepayments decreased significantly because of the stable interest rate environment; another very different interest rate environment could lead to a significantly different result. These factors reduce the predictability of the timing of these sources of funds.

Our primary investing activities are the origination and purchase of one-to four-family real estate loans, multi-family and commercial real estate loans, home equity loans, other consumer loans, commercial business loans, the purchase of mortgage-related securities, and to a lesser extent, the purchase of investment securities.

These investing activities were funded by principal payments on mortgage loans and mortgage-related securities, calls and maturities on investment securities, borrowings, deposits, and funds provided by our operating activities.

At December 31, 2004, we exceeded each of the applicable regulatory capital requirements for our savings bank subsidiary. In order to be classified as "well-capitalized" by the FDIC we are required to have leverage (tier 1) capital of at least 5.00%. To be classified as a well-capitalized bank by the FDIC, we must also have a risk-based total capital ratio of at least 10.00%. At December 31, 2004, Bank Mutual had a risk-based total capital ratio of 28.85% and a leverage ratio of 13.74%. See "Notes to Consolidated Financial Statements---Note 8. Shareholders' Equity." We believe that our relatively high capital levels as compared to industry standards, which primarily resulted from our stock offering in 2003, provide us with the flexibility to increase leverage through borrowings, as we did in 2004, and to prudently repurchase shares, as we have with share repurchase programs in 2004 and 2005.

Shareholders' equity is decreased by unearned ESOP shares, which represents shares in the Bank Mutual Employee Stock Ownership Plan which have not yet been earned by participating employees, and unearned deferred compensation, which represents stock grants under the management recognition plan ("MRP") component of its 2004 and 2001 Stock Incentive Plans. See "Notes to Consolidated Financial Statements---Note 1. Summary of Significant Accounting Policies." Shareholders' equity is decreased by \$4.8 million of accumulated other comprehensive income, consisting primarily of net unrealized losses, net of taxes, on securities available-for-sale. Bank Mutual Corporation in 2004 repurchased 6,642,521 shares under its stock repurchase programs, of which 955,000 restricted shares were re-issued to officers and directors in accordance with the 2004 Stock Incentive Plan and 298,736 were re-issued for exercises of stock options.

Cash and cash equivalents decreased \$48.9 million during 2004; however, we still maintained \$37.6 million of cash and cash equivalents at December 31, 2004. The Company used \$378.6 million for investing activities, primarily as a result of purchases of mortgage-related and investment securities and an increase in the loan portfolio, partially offset by principal repayments on mortgage-related securities. The cash from operating activities of \$27.7 million is primarily a result of Bank Mutual's net income for the year, and non-cash expenses, offset by a net increase in other assets. Cash provided by financing activities of \$302.0 million resulted primarily from the net proceeds of the borrowings, offset by our repurchases of securities and decreases in deposits.

## **Contractual Obligations, Commitments, Contingent Liabilities, and Off-balance Sheet Arrangements**

The Company has various financial obligations, including contractual obligations and commitments, that may require future cash payments.

The following table presents, as of December 31, 2004, significant fixed and determinable contractual obligations to third parties by payment date. Further discussion of the nature of each obligation is included in the referenced note to the consolidated financial statements.

	Payments Due In				
	One Year Or Less	One to Three Years	Three to Five Years	Over Five Years	Total
	(In thousands)				
Deposits without a stated maturity (a)	\$840,390	\$ -	\$ -	\$ -	\$ 840,390
Certificates of deposits (a)	584,172	467,046	91,273	-	1,142,491
Borrowed funds (a)	168,010	407,955	1,025	46,935	623,925
Operating leases	1,142	1,616	1,223	455	4,436
Purchase obligations	2,160	4,320	4,320	750	11,520
Deferred retirement plans and deferred compensation plans	221	392	275	7,189	8,077

(a) Excludes interest to be paid in the periods indicated.

The Company's operating lease obligations represent short and long-term lease and rental payments for facilities, certain software and data processing and other equipment. Purchase obligations represent obligations under agreements to purchase goods or services that are enforceable and legally binding on the Company and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. The purchase obligation amounts presented above primarily relate to certain contractual payments for services provided for information technology.

The Company also has obligations under its deferred retirement plan for directors as described in Note 10 to the consolidated financial statements.

The following table details the amounts and expected maturities of significant off balance sheet commitments as of December 31, 2004. Further discussion of these commitments is included in Note 13 to the consolidated financial statements.

	Payments Due In				
	One Year Or Less	One to Three Years	Three to Five Years	Over Five Years	Total
	(In thousands)				
Commitments to extend credit:					
Commercial	\$5,635	\$ -	\$ -	\$ -	\$5,635
Residential real estate	68,204	-	-	-	68,204
Revolving home equity and credit card lines	154,213	-	-	-	154,213
Standby letters of credit	3,618	85	-	-	3,703
Commercial letters of credit	22,261	-	-	-	22,261
Unused commercial lines of credit	21,098	-	-	-	21,098
Net commitments to sell mortgage loans	10,545	-	-	-	10,545

Commitments to extend credit, including loan commitments, standby letters of credit, unused lines of credit and commercial letters of credit do not necessarily represent future cash requirements, since these commitments often expire without being drawn upon.

## Impact of Inflation and Changing Prices

The financial statements and accompanying notes of Bank Mutual Corporation have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). GAAP generally requires the measurement of financial position and operating results in terms of historical dollars without consideration for changes in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of our operations. Unlike industrial companies, our assets and liabilities are primarily monetary in nature. As a result, changes in market interest rates have a greater impact on performance than do the effects of inflation.

## Risk Factors

In addition to the various factors discussed above, you should consider carefully the following risk factors when evaluating Bank Mutual Corporation's performance and outlook.

*The Current Interest Rate Environment is Having an Adverse Impact on Our Net Interest Income.* Beginning in June 2004, the Federal Reserve Board began increasing the Federal Funds target rate with the targeted rate being increased five times in 2004 and once in February 2005. Since these interest rate increases began, interest rates on short-term deposits have increased slightly. For example, the Federal Funds target rate was 1.00% as of December 31, 2003 and at December 31, 2004, the rate was 2.25%. The ten-year Treasury Bond rate was 4.25% as of December 31, 2003 and at December 31, 2004 the rate was 4.23%.

If interest rates continue to rise, the amount of interest we pay on deposits could increase more quickly than the amount of interest we receive on our loans, mortgage-related securities and investment securities. This could cause our profits to decrease. Rising interest rates would likely reduce the value of our mortgage-related securities and investment securities and may decrease demand for loans and make it more difficult for borrowers to repay their loans. Increasing market interest rates may also depress property values, which could affect the value of collateral securing our loans. For additional information on our exposure to interest rates, see "Quantitative and Qualitative Disclosures about Market Risk--Management of Interest Rate Risk."

*If Our Allowance for Loan Losses is Not Sufficient to Cover Actual Loan Losses, Our Earnings Could Decrease.* Our loan customers may not repay their loans according to the terms of the loans, and the collateral securing the payment of these loans may be insufficient to pay any remaining loan balance. We therefore may experience significant loan losses, which could have a material adverse effect on our operating results.

Material additions to our allowance also would materially decrease our net income, and the charge-off of loans may cause us to increase the allowance. We make various assumptions and judgments about the collectibility of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. We rely on our loan quality reviews, our experience and our evaluation of economic conditions, among other factors, in determining the amount of the allowance for loan losses. If our assumptions prove to be incorrect, our allowance for loan losses may not be sufficient to cover losses inherent in our loan portfolio, resulting in additions to our allowance.

Our emphasis on a diverse loan portfolio has been one of the more significant factors we have taken into account in evaluating our allowance for loan losses and provision for loan losses. If we were to further increase the amount of loans in our portfolio other than traditional real estate loans, we may decide to make increased provisions for loan losses. In addition, bank regulators periodically review our allowance for loan losses and may require us to increase our provision for loan losses or recognize further loan charge-offs.

*We Are Expanding Our Lending Activities in Riskier Areas.* We have identified commercial real estate, commercial business and consumer loans as areas for increased lending emphasis. While increased lending diversification is expected to increase interest income, non-residential loans carry greater risk of payment default than residential real estate loans. As the volume of these loans increase, credit risk increases. In the event of substantial borrower defaults, our provision for loan losses would increase and therefore, earnings would be reduced.

Our consumer loan portfolio included \$53.3 million of indirect auto loans at December 31, 2004. Borrowers may be more likely to become delinquent on an automobile loan than on a residential real estate loan. Moreover, unlike the collateral for real estate loans, automobiles depreciate rapidly and, in the event of default, principal loss as a percent of the loan balance depends upon the mileage and condition of the vehicle at the time of repossession, over which

the Bank has no control. Similarly, any non-real estate collateral securing commercial business loans may depreciate over time and fluctuate in value.

*Increases in Market Interest Rates are Likely to Adversely Affect Equity.* As of December 31, 2004, we owned \$1.3 billion of securities available-for-sale. Generally accepted accounting principles require that we carry these securities at fair value on our balance sheet. Unrealized gains or losses on these securities, reflecting the difference between the fair market value and the amortized cost, net of its tax effect, are carried as a component of shareholders' equity. When market rates of interest increase, the fair value of our securities available-for-sale generally decreases and equity correspondingly decreases. When rates decrease, fair value generally increases and shareholders' equity correspondingly increases. As of December 31, 2004, the Company's available-for-sale portfolio had an unrealized loss of \$5.8 million.

*Low Demand for Real Estate Loans May Lower Our Profitability.* Making loans secured by real estate is our primary business and primary source of profits. If customer demand for real estate loans decreases, our profits may decrease because our alternative investments, primarily securities, earn less income for us than real estate loans. Customer demand for loans secured by real estate could be reduced by a weaker economy, an increase in unemployment, a decrease in real estate values or an increase in interest rates.

*Strong Competition Within Our Market Area May Reduce Our Customer Base.* We encounter strong competition both in attracting deposits and originating real estate and other loans. We compete with commercial banks, savings institutions, mortgage banking firms, credit unions, finance companies, mutual funds, insurance companies, and brokerage and investment banking firms. Our market area includes branches of several commercial banks that are substantially larger than us in terms of deposits and loans. In addition, tax exempt credit unions operate in most of our market area and aggressively price their products and services to a large part of the population. Our profitability depends upon our continued ability to successfully maintain or increase our market share.

*We Have Significant Intangible Assets Which May Need to be Written Off as an Expense in the Future.* The Company has approximately \$52.6 million in goodwill, \$4.4 million in other intangible assets and \$4.5 million of mortgage servicing rights as of December 31, 2004. As a result of SFAS No. 142, the Company no longer amortizes goodwill but will continue to amortize the other intangible assets over seven to fifteen years and will evaluate the mortgage servicing rights for impairment on a monthly basis. We will periodically check goodwill, and the other intangible assets for impairment. At some point in the future, our intangible assets may become impaired, and we would need to write them off as a reduction to earnings in the period in which they became impaired.

*Stock-Based and Other Benefits Affect Our Results.* We have adopted stock incentive plans which provided for the granting of options to purchase common stock and for awards of common stock to our eligible officers, employees and directors. We also have an employee stock ownership plan, and have adopted a restoration plan that will supplement the benefits to selected executive officers under the employee stock ownership plan and our 401(k) plan. The cost of the employee stock ownership plan will vary based on our stock price at specific points in the future. Additionally, we experienced an increase in employee health care costs in 2004, and expect further increases in 2005. These expenses will continue to affect our future earnings, as may other factors, such as government mandates, which would further increase the cost of compensation and/or benefits that are provided to employees.

*Wisconsin Tax Developments Could Reduce Our Net Income.* The Bank has Nevada subsidiaries which hold and manage investment securities and other investments. Because the subsidiaries are out of state, related income has not been subject to tax in Wisconsin. The Wisconsin Department of Revenue has implemented a program for the audit of Wisconsin financial institutions who have formed and contributed assets to subsidiaries located in Nevada, and presumably will seek to impose Wisconsin state income taxes on income from those operations, at least on a going forward basis. The Department has announced terms and conditions on which it has settled similar issues with other financial institutions in the state. The Company believes that it will need more specific detail than was included in that announcement or subsequent communications to quantify in any definitive way the Department's view of its exposure, either for past periods or with respect to operations going forward, and to evaluate the Company's alternatives. A determination on how to proceed will depend in part on further communication from and actions by the Department.

Depending upon the terms and circumstances, an adverse resolution of these matters could result in additional Wisconsin tax obligations for prior periods and/or higher Wisconsin taxes going forward, with a substantial negative impact on the earnings of Bank Mutual Corporation. We may also need to incur costs in the future to address any action taken against us by the Department.

*Our Ability to Grow May be Limited if We Cannot Make Acquisitions.* In an effort to fully deploy the capital we raised in our stock offering, we intend to seek to expand our banking franchise, internally by de novo branching and by acquiring other financial institutions or branches and other financial services providers. However, we have no specific plans for acquisitions at this time. Our ability to grow through selective acquisitions of other financial institutions or branches will depend on successfully identifying, acquiring and integrating those institutions or branches. We cannot assure you that we will be able to generate internal growth or identify attractive acquisition candidates, make acquisitions on favorable terms or successfully integrate any acquired institutions or branches.

*Our Return on Shareholders' Equity Is Reduced as a Result of the 2003 Offering.* Net income divided by average shareholders' equity, known as "return on equity," is a ratio many investors use to compare the performance of a financial institution to its peers. Due to the large amount of additional capital that we raised in our stock offering in late 2003, our return on equity decreased as compared to our performance in prior years, pending optimal deployment of that additional capital. While we have deployed a significant amount of that capital (including market purchases of our shares in our share repurchase programs), our capital remains relatively high by industry standards. Until we can increase our net interest income and non-interest income, we expect that our return on equity may be below the industry average, which may negatively impact the value of our common stock.

*Our Borrowings Have Significantly Increased, Which Further Exposes Us to the Risks of Leverage.* Although our capital levels remain high, we substantially increased our borrowings in 2004. Borrowings tend to be a more costly source of funds than deposits. In addition, if interest rates change substantially, we may be less able to adjust our interest rate exposure on these borrowings than we would in the case of deposits. We will also need to have capital resources or other sources of funds to repay these borrowings when they come due, which we cannot assure.

*Economic Conditions and World Events Could Affect Our Earnings.* The United States economy began to improve in 2003 and continued to improve in 2004 according to economists. However, significant uncertainty remains in the economy. We do not know how swift or strong the recovery will be or how long it will continue. The effects of a recession, or a weak economy, can significantly affect our operations and profitability. For example, higher unemployment and reduced business sales or profits can make it more difficult for borrowers to repay their loans. Similarly, reduced income or confidence can lead consumers to reduce their purchases, and thus reduce loan demand.

The national and local economies were adversely affected by the attacks of September 11, 2001 and their aftermath and other world events such as the Iraq conflict. Bank Mutual Corporation, and the economy as a whole, may be affected by future world events, such as acts of terrorism, developments in the war on terrorism, conflict in the Middle East, and the international situation in North Korea and Iran.

## Quarterly Financial Information

The following table sets forth certain unaudited quarterly data for the periods indicated:

	Quarter Ended			
	March 31	June 30	September 30	December 31
	(In thousands, except per share amounts)			
2004 (unaudited)				
Interest income	\$ 36,661	\$ 36,253	\$ 36,756	\$ 39,251
Interest expense	14,569	14,370	14,413	15,146
Net interest income	22,092	21,883	22,343	24,105
Provision for loan losses	490	384	267	189
Net income after provision for loan losses	21,602	21,499	22,076	23,916
Total noninterest income	3,847	4,429	3,876	4,023
Total noninterest expense	14,753	15,019	15,059	15,251
Income before income taxes	10,696	10,909	10,893	12,688
Income taxes	3,622	3,791	3,859	4,360
Net income	\$ 7,074	\$ 7,118	\$ 7,034	\$ 8,328
Earnings per share - Basic	\$0.09	\$0.09	\$0.09	\$0.11
Earnings per share - Diluted	\$0.09	\$0.09	\$0.09	\$0.11
Cash dividend paid per share	\$0.04	\$0.04	\$0.05	\$0.05
2003 (unaudited)				
Interest income	\$ 36,696	\$35,576	\$33,802	\$ 34,996
Interest expense	18,510	18,077	16,975	15,920
Net interest income	18,186	17,499	16,827	19,076
Provision for loan losses	258	109	—	937
Net income after provision for loan losses	17,928	17,390	16,827	18,139
Total noninterest income	4,505	5,037	6,166	3,910
Total noninterest expense	13,381	14,360	14,080	13,787
Income before income taxes	9,052	8,067	8,913	8,262
Income taxes	3,183	2,887	2,912	2,713
Net income	\$ 5,869	\$ 5,180	\$ 6,001	\$ 5,549
Earnings per share - Basic	\$ 0.08	\$ 0.07	\$ 0.08	\$ 0.07
Earnings per share - Diluted	\$ 0.08	\$ 0.06	\$ 0.08	\$ 0.07
Cash dividend paid per share	\$ 0.027	\$ 0.027	\$ 0.030	\$ 0.035

## Recent Accounting Developments

We discuss recent accounting changes in the "Notes to Consolidated Financial Statement--Note 1. Summary of Significant Accounting Policies--Recent Accounting Changes."

## **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

### **Management of Interest Rate Risk**

The Bank's ability to maintain net interest income depends upon earning a higher yield on assets than the rates we pay on deposits and borrowings. Fluctuations in interest rates will ultimately impact both our level of income and expense recorded on a large portion of our assets and liabilities. Fluctuations in interest rates will also affect the market value of all interest-earning assets, other than those which possess a short term to maturity.

Interest rate sensitivity is a measure of the difference between amounts of interest-earning assets and interest-bearing liabilities which either reprice or mature during a given period of time. The difference, or the interest rate sensitivity "gap," provides an indication of the extent to which our interest rate spread will be affected by changes in interest rates. See "Gap Analysis" below.

Due to the nature of our operations, we are not directly subject to foreign currency exchange or commodity price risk. Instead, our real estate loan portfolio, concentrated in Wisconsin, is subject to risks associated with the local economy.

We seek to coordinate asset and liability decisions so that, under changing interest rate scenarios, earnings will remain within an acceptable range.

The primary objectives of our interest rate management strategy are to:

- maintain earnings and capital within self-imposed parameters over a range of possible interest rate environments;
- coordinate interest rate risk policies and procedures with other elements of our business plan, all within the context of the current business environment and our capital and liquidity requirements; and
- manage interest rate risk in a manner consistent with the approved guidelines and policies set by our board of directors.

To achieve the objectives of managing interest rate risk, our Asset/Liability committee meets periodically to discuss and monitor the market interest rate environment and provides reports to the board of directors. This committee is comprised of senior management.

Historically, our lending activities have emphasized one- to four-family first and second mortgage loans. Our primary source of funds has been deposits and borrowings, consisting primarily of time deposits and borrowings which have substantially shorter terms to maturity than the loan portfolio. We have employed certain strategies to manage the interest rate risk inherent in the asset/liability mix, including:

- emphasizing the origination of adjustable-rate and certain 15-year fixed rate mortgage loans for our portfolio, and selling certain 15 and 20 year fixed rate mortgage loans and all 30-year fixed rate mortgage loans;
- maintaining a significant level of investment securities and mortgage-related securities with a weighted average life of less than eight years or with interest rates that reprice in less than five years; and
- managing deposits and borrowings to provide stable funding.

We believe that the frequent repricing of our adjustable-rate mortgage loans, the cash flows from our 15-year fixed rate real estate loans, the shorter duration of our consumer loans, and adjustable rate features and shorter durations of our investment securities, reduce our exposure to interest rate fluctuations.

*Gap Analysis.* Repricing characteristics of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are "interest rate sensitive" and by monitoring a financial institution's interest rate sensitivity "gap." An asset or liability is said to be "interest rate sensitive" within a specific time period if it will mature or reprice within that time period. The interest rate sensitivity gap is defined as the difference between the amount of interest-earning assets maturing or repricing within a specific time period and the amount of interest-bearing liabilities maturing or repricing within that same time period.

A gap is considered positive when the amount of interest-earning assets maturing or repricing within a specific time period exceeds the amount of interest-bearing liabilities maturing or repricing within that specific time period. A gap is considered negative when the amount of interest-bearing liabilities maturing or repricing within a specific time period exceeds the amount of interest-earning assets maturing or repricing within the same period. During a period of rising interest rates, a financial institution with a negative gap position would be expected, absent the effects of other factors, to experience a greater increase in the costs of its liabilities relative to the yields of its assets and thus a decrease in the institution's net interest income. An institution with a positive gap position would be expected, absent the effect of other factors, to experience the opposite result. Conversely, during a period of falling interest rates, a negative gap would tend to result in an increase in net interest income while a positive gap would tend to reduce net interest income.

At December 31, 2004, based on the assumptions below, our interest-bearing liabilities maturing or repricing within one year exceeded our interest-earning assets maturing or repricing within the same period by \$58.1 million. This represented a negative cumulative one-year interest rate sensitivity gap of 1.69%, and a ratio of interest-earning assets maturing or repricing within one year to interest-bearing liabilities maturing or repricing within one year of 95.5%.

The following table presents the amounts of our interest-earning assets and interest-bearing liabilities outstanding at December 31, 2004, which we anticipate to reprice or mature in each of the future time periods shown. The information presented in the following table is based on the following assumptions:

- i) Investment securities - based upon contractual maturities and if applicable, call dates.
- ii) Mortgage-related securities - based upon an independent outside source for determining cash flows (prepayment speeds).
- iii) Loans - based upon contractual maturities, repricing date, if applicable, scheduled repayments of principal and projected prepayments of principal based upon our historical experience or anticipated prepayments.
- iv) Deposits - based upon contractual maturities and our historical decay rates.
- v) Borrowings - based upon the earlier of call date or final maturity.



At December 31, 2004

	Within Three Months	Three to Twelve Months	More Than One Year - Three Years	More Than Three Years - Five Years	Over Five Years	Total
(Dollars in thousands)						
Interest-earning assets:						
Loans receivable:						
Mortgage loans:						
Fixed	\$ 23,229	\$ 73,016	\$ 157,070	\$ 93,176	\$191,777	\$ 538,268
Adjustable	163,275	192,319	323,793	113,293	15,627	808,307
Consumer loans	106,509	134,596	152,339	51,776	32,051	477,271
Commercial and industrial loans	17,792	19,767	26,317	5,297	997	70,170
Interest-earning deposits	707	!	!	!	!	707
Investment securities	50,977	1,750	14,719	!	!	67,446
Mortgage-related securities:						
Fixed	100,581	252,228	444,063	203,092	215,913	1,215,877
Adjustable	57,420	!	!	!	!	57,420
Other interest-earning assets	38,186	!	!	!	!	38,186
Total interest-earning assets	558,676	673,676	1,118,301	466,634	456,365	3,273,652
Noninterest-bearing and interest- bearing liabilities:						
Noninterest-bearing demand accounts	2,498	7,163	16,890	14,098	71,206	111,855
Interest-bearing liabilities:						
Deposits:						
Interest-bearing demand accounts	3,831	10,987	25,907	21,625	109,200	171,550
Savings accounts	7,187	19,331	43,781	34,548	142,592	247,439
Money market accounts	309,410	!	!	!	!	309,410
Time deposits	289,191	332,116	429,212	91,197	!	1,141,716
Advance payments by borrowers for taxes and insurance	2,796	!	!	!	!	2,796
Borrowings	287,682	18,278	409,344	2,602	43,619	761,525
Total interest-bearing liabilities	902,595	387,875	925,134	164,070	366,617	2,746,291
Interest rate sensitivity gap	\$(343,919)	\$285,801	\$ 193,167	\$302,564	\$ 89,728	\$ 527,361
Cumulative interest rate sensitivity gap	\$(343,919)	\$(58,118)	\$135,049	\$437,613	\$527,361	
Cumulative interest rate sensitivity gap as a percentage total assets	(9.98)%	(1.69)%	3.92%	12.70%	15.31%	
Cumulative interest-earning assets as a percentage of interest bearing liabilities	61.90%	95.50%	106.10%	118.39%	119.20%	

The methods used in the previous table have some inherent shortcomings. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in different degrees to changes in market interest rates. Interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Certain assets, such as adjustable-rate loans, have features which limit changes in interest rates on a short-term basis and over the life of the loan. If interest rates change, prepayment and early withdrawal levels would likely deviate significantly from those assumed in calculating the table. Finally, the ability of borrowers to make payments on their adjustable-rate loans may decrease if interest rates increase.

## Present Value of Equity

In addition to the gap analysis table, we also use a simulation model to monitor interest rate risk. The model reports the present value of equity in different interest rate environments, assuming an instantaneous and permanent interest rate shock to all interest rate-sensitive assets and liabilities. The present value of equity is the difference between the present value of expected cash flows of interest rate-sensitive assets and liabilities. The changes in market value of assets and liabilities due to changes in interest rates reflect the interest rate sensitivity of those assets and liabilities as their values are derived from the characteristics of the asset or liability (i.e., fixed rate, adjustable-rate, caps, floors) relative to the current interest rate environment. For example, in a rising interest rate environment the fair market value of a fixed rate asset will decline, whereas the fair market value of an adjustable-rate asset, depending on its repricing characteristics, may not decline. Increases in the market value of assets will increase the present value of equity whereas decreases in market value of assets will decrease the present value of equity. Conversely, increases in the market value of liabilities will decrease the present value of equity whereas decreases in the market value of liabilities will increase the present value of equity.

The following table presents the estimated present value of equity over a range of interest rate change scenarios at December 31, 2004. The present value ratio shown in the table is the present value of equity as a percent of the present value of total assets in each of the different rate environments. For purposes of this table, we have made assumptions such as prepayment rates and decay rates similar to those used for the gap analysis table.

Change in Interest Rates (Basis Points)	Present Value of Equity			Present Value of Equity as Percent of Present Value of Assets	
	Dollar Amount	Dollar Change	Percent Change	Present Value Ratio	Percent Change
	(Dollars in thousands)				
+300	\$539,401	\$(243,693)	(31.10)%	17.05%	(24.20)%
+200	622,280	(160,815)	(20.50)	19.03	(15.30)
+100	708,961	(74,133)	(9.50)	20.97	(6.80)
0	783,095	--	--	22.49	--
-100	816,333	33,239	4.20	23.00	2.30
-200	817,196	34,101	4.40	22.69	0.90
-300	810,600	27,506	3.50	22.21	(1.20)

As in the case of the gap analysis table, the methods we used in the previous table have some inherent shortcomings. This type of modeling requires that we make assumptions which may not reflect the manner in which actual yields and costs respond to changes in market interest rates. For example, we make assumptions regarding the acceleration rate of the prepayment speeds of higher yielding mortgage loans. Prepayments will accelerate in a falling rate environment and the reverse will occur in a rising rate environment. We also assume that decay rates on core deposits will accelerate in a rising rate environment and the reverse in a falling rate environment. The table assumes that we will take no action in response to the changes in interest rates, when in practice rate changes on certain products, such as savings deposits, may lag market changes. In addition, prepayment estimates and other assumptions within the model are subjective in nature, involve uncertainties, and therefore cannot be determined with precision. Accordingly, although the present value of the equity model may provide an estimate of our interest rate risk at a particular point in time, such measurements are not intended to and do not provide a precise forecast of the effect of changes in interest rates on our present value of equity.

## **Item 8. Financial Statements and Supplementary Data**

Report of Ernst & Young LLP, Independent Registered Public Accounting Firm

### **Report on Consolidated Financial Statements**

Board of Directors  
Bank Mutual Corporation and Subsidiaries

We have audited the accompanying consolidated statements of financial condition of Bank Mutual Corporation (the Company) and subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and subsidiaries at December 31, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2004, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated January 28, 2005 expressed an unqualified opinion thereon.

As discussed in Note 1, in 2003 the Company changed its method for accounting for goodwill.

/s/ Ernst & Young LLP

Milwaukee, Wisconsin  
January 28, 2005

# Bank Mutual Corporation and Subsidiaries

## Consolidated Statements of Financial Condition

	December 31	
	2004	2003
	(In Thousands)	
<b>Assets</b>		
Cash and due from banks	\$ 36,868	\$ 36,384
Federal funds sold	—	30,000
Interest-earning deposits	707	20,119
Cash and cash equivalents	37,575	86,503
Securities available-for-sale, at fair value:		
Investment securities	68,753	67,854
Mortgage-related securities	1,266,224	1,053,349
Loans held for sale	4,987	4,056
Loans receivable, net	1,875,885	1,712,278
Goodwill	52,570	52,570
Other intangible assets	4,412	5,073
Mortgage servicing rights	4,542	4,698
Other assets	130,351	122,146
	<u>\$3,445,299</u>	<u>\$3,108,527</u>
<b>Liabilities and shareholders' equity</b>		
<b>Liabilities:</b>		
Deposits	\$1,982,881	\$2,052,290
Borrowings	761,525	299,491
Advance payments by borrowers for taxes and insurance	2,796	2,987
Other liabilities	25,348	22,679
	<u>2,772,550</u>	<u>2,377,447</u>
Minority interest in real estate development	2,295	—
<b>Shareholders' equity:</b>		
Preferred stock – \$.01 par value:		
Authorized– 20,000,000 shares in 2004 and 2003		
Issued and outstanding – none in 2004 and 2003	—	—
Common stock – \$.01 par value:		
Authorized– 200,000,000 shares in 2004 and 2003		
Issued – 78,783,849 shares in 2004 and 78,775,779 shares in 2003		
Outstanding – 73,485,113 in 2004 and 78,775,779 in 2003	788	788
Additional paid-in capital	495,858	495,990
Retained earnings	258,110	241,958
Unearned ESOP shares	(4,865)	(5,766)
Accumulated other comprehensive income	(4,844)	149
Unearned deferred compensation	(10,076)	(2,039)
Treasury stock – 5,298,736 shares in 2004	(64,517)	—
Total shareholders' equity	<u>670,454</u>	<u>731,080</u>
	<u>\$3,445,299</u>	<u>\$3,108,527</u>

See accompanying notes to consolidated financial statements.

# Bank Mutual Corporation and Subsidiaries

## Consolidated Statements of Income

	Year ended December 31		
	2004	2003	2002
	<i>(In Thousands, Except Per Share Amounts)</i>		
Interest income:			
Loans	\$97,330	\$104,623	\$124,490
Investment securities	3,956	4,654	5,580
Mortgage-related securities	47,431	29,164	32,256
Interest-earning deposits	204	2,629	3,106
Total interest income	148,921	141,070	165,432
Interest expense:			
Deposits	42,117	51,419	64,891
Borrowings	16,345	17,975	22,544
Advance payments by borrowers for taxes and insurance	36	88	243
Total interest expense	58,498	69,482	87,678
Net interest income	90,423	71,588	77,754
Provision for loan losses	1,330	1,304	760
Net interest income after provision for loan losses	89,093	70,284	76,994
Noninterest income:			
Service charges on deposits	4,630	4,814	4,634
Brokerage and insurance commissions	2,875	2,527	3,157
Loan related fees and servicing revenue (loss)	1,590	636	(1,056)
Gain on sales of loans	1,569	6,855	5,993
Gain on sales of securities	537	121	9
Gain on sale of real estate	2,009	-	-
Loss on retirement of debt	(1,737)	-	-
Other	4,702	4,665	3,939
Total noninterest income	16,175	19,618	16,676
Noninterest expenses:			
Compensation, payroll taxes and other employee benefits	36,214	31,747	31,350
Occupancy and equipment	10,853	10,871	10,533
Amortization of other intangible assets	661	661	662
Other	12,354	12,329	11,624
Total noninterest expenses	60,082	55,608	54,169
Income before income taxes	45,186	34,294	39,501
Income taxes	15,632	11,695	12,956
Net income	\$29,554	\$ 22,599	\$ 26,545
Per share data:			
Earnings per share – basic	<u>\$0.39</u>	<u>\$0.30</u>	<u>\$0.34</u>
Earnings per share – diluted	<u>\$0.38</u>	<u>\$0.29</u>	<u>\$0.34</u>
Cash dividends per share paid	<u>\$0.18</u>	<u>\$0.12</u>	<u>\$0.093</u>

See accompanying notes to consolidated financial statements.

# Bank Mutual Corporation and Subsidiaries

## Consolidated Statements of Changes in Shareholder's Equity

	Common Stock	Additional Paid-In Capital	Retained Earnings	Unearned ESOP Shares
<i>(In Thousands, Except Per Share Amounts)</i>				
Balances at January 1, 2002	\$820	\$107,446	\$201,777	\$(7,850)
Comprehensive income:				
Net income	-	-	26,545	-
Other comprehensive income				
Change in net unrealized gain (loss) on securities available-for-sale, net of deferred income tax liability of \$2,593	-	-	-	-
Total comprehensive income	-	-	-	-
Purchase of treasury stock	-	-	-	-
Issuance of management recognition plan shares	-	1,207	-	1,203
Committed ESOP Shares	-	(176)	-	-
Cash dividends (\$0.093 per share)	-	-	-	-
Purchase of shares for the ESOP	-	-	(3,390)	-
Balances at December 31, 2002	820	108,477	224,932	(6,647)
Comprehensive income:				
Net income	-	-	22,599	-
Other comprehensive income				
Change in net unrealized gain (loss) on securities available-for-sale, net of deferred income tax liability of \$5,853	-	-	-	-
Total comprehensive income	-	-	-	-
Purchase of treasury stock	-	-	-	-
Committed ESOP shares	-	2,087	352	881
Exercise of stock options	1	(253)	-	-
Amortization of deferred compensation	-	34	-	-
Cash dividends (\$0.12 per share)	-	-	(5,925)	-
Proceeds from sale of stock	(33)	385,645	-	-
Balances at December 31, 2003	788	495,990	241,958	(5,766)
Comprehensive income:				
Net income	-	-	29,554	-
Other comprehensive income				
Change in net unrealized gain (loss) on securities available-for-sale, net of deferred income tax benefit of \$2,036	-	-	-	-
Minimum pension liability, net of deferred income tax benefit of \$800	-	-	-	-
Total comprehensive income	-	-	-	-
Purchase of treasury stock	-	-	-	-
Issuance of management recognition plan shares	-	(22)	-	-
Committed ESOP shares	-	2,800	-	901
Exercise of stock options	-	(2,910)	-	-
Amortization of deferred compensation	-	-	-	-
Cash dividends (\$0.18 per share)	-	-	(13,402)	-
Balances at December 31, 2004	\$788	\$495,858	\$258,110	\$(4,865)

# Bank Mutual Corporation and Subsidiaries

## Consolidated Statements of Changes in Shareholder's Equity

	Accumulated Other Comprehensive Income (Loss)	Unearned Deferred Compensation	Treasury Stock	Total
<i>(In Thousands, Except Per Share Amounts)</i>				
Balances at January 1, 2002	\$ 6,018	\$(4,047)	\$ (66)	\$304,098
Comprehensive income:				
Net income	-	-	-	26,545
Other comprehensive income				
Change in net unrealized gain (loss) on securities available-for-sale, net of deferred income tax liability of \$2,593	4,469	-	-	4,469
Total comprehensive income	-	-	-	31,014
Purchase of treasury stock	-	-	(12,417)	(12,417)
Issuance of management recognition plan shares	-	-	-	2,410
Committed ESOP Shares	-	-	622	446
Cash dividends (\$0.093 per share)	-	914	-	914
Purchase of shares for the ESOP	-	-	-	(3,390)
Balances at December 31, 2002	10,487	(3,133)	(11,861)	323,075
Comprehensive income:				
Net income	-	-	-	22,599
Other comprehensive income	-	-	-	-
Change in net unrealized gain (loss) on securities available-for-sale, net of deferred income tax liability of \$5,853	(10,338)	-	-	(10,338)
Total comprehensive income	-	-	-	12,261
Purchase of shares for the ESOP	-	-	(8,011)	(8,011)
Committed ESOP shares	-	-	-	3,320
Exercise of stock options	-	-	1,192	940
Amortization of deferred compensation	-	1,094	(461)	667
Cash dividends (\$0.12 per share)	-	-	-	(5,925)
Proceeds from sale of stock	-	-	19,141	404,753
Balances at December 31, 2003	149	(2,039)	-	731,080
Comprehensive income:				
Net income	-	-	-	29,554
Other comprehensive income				
Change in net unrealized gain (loss) on securities available-for-sale, net of deferred income tax benefit of \$2,036	(3,801)	-	-	(3,801)
Minimum pension liability, net of deferred income tax benefit of \$800	(1,192)	-	-	(1,192)
Total comprehensive income	-	-	-	24,561
Purchase of treasury stock	-	-	(78,859)	(78,859)
Issuance of management recognition plan shares	-	(10,193)	10,215	-
Committed ESOP shares	-	-	-	3,701
Exercise of stock options	-	-	4,127	1,217
Amortization of deferred compensation	-	2,156	-	2,156
Cash dividends (\$0.18 per share)	-	-	-	(13,402)
Balance at December 31, 2004	\$(4,844)	\$(10,076)	\$(64,517)	\$670,454

# Bank Mutual Corporation and Subsidiaries

## Consolidated Statements of Cash Flows

	Year ended December 31		
	2004	2003	2002
	(In Thousands)		
<b>Operating activities:</b>			
Net income	\$29,554	\$22,599	\$ 26,545
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	1,330	1,304	760
Provision for depreciation	3,253	3,021	2,811
Amortization of intangibles	661	661	662
Net (increase) decrease in mortgage servicing rights	156	(1,638)	1,190
Amortization of cost of stock benefit plans	5,857	3,987	3,298
Net premium amortization on securities	355	2,107	119
Net change in loans originated for sale	638	49,770	(8,657)
Net gain on sale of available-for-sale securities	(537)	(121)	(9)
Gain on sales of loans	(1,569)	(6,855)	(5,993)
Gain on sale of investment real estate	(2,009)	-	-
Gain on sale of real estate owned	(19)	(48)	(184)
Increase (decrease) in other liabilities	5,166	(8,022)	(9,971)
Increase in other assets	(14,633)	(5,447)	(2,330)
(Increase) decrease in accrued interest receivable	(530)	575	2,192
Net cash provided by operating activities	27,673	61,893	10,433
<b>Investing activities:</b>			
Net purchases of investments in mutual funds	(968)	(10,903)	(1,030)
Proceeds from maturities of investment securities	27,000	124,872	51,897
Purchases of investment securities	(25,512)	(117,598)	(35,360)
Purchases of mortgage-related securities	(523,334)	(923,451)	(365,312)
Principal repayments on mortgage-related securities	302,848	470,994	275,518
Proceeds from sale of investment securities	537	8,076	4,032
Net (increase) decrease in loans receivable	(159,892)	(26,459)	143,192
Proceeds from sale of investment real estate	2,182	-	-
Proceeds from sale of foreclosed properties	3,223	1,003	1,182
Increase in Federal Home Loan Bank stock	(2,688)	(2,613)	(1,652)
Purchases of premises and equipment	(2,029)	(3,896)	(3,658)
Net cash provided (used) by investing activities	(378,633)	(479,975)	68,809



# Bank Mutual Corporation and Subsidiaries

## Consolidated Statements of Cash Flows (continued)

	Year ended December 31		
	2004	2003	2002
	<i>(In Thousands)</i>		
<b>Financing activities:</b>			
Net increase (decrease) in deposits	\$ (68,767)	\$ (73,371)	\$ 36,761
Net increase (decrease) in short-term borrowings	137,600	(22,679)	(656)
Proceeds from long-term borrowings	556,446	28,125	8,245
Repayments on long-term borrowings	(232,012)	(60,933)	(117,971)
Net decrease in advance payments by borrowers for taxes and insurance	(191)	(73)	(439)
Proceeds from sale of stock	-	404,753	-
Proceeds from exercise of stock options	1,217	940	472
Cash dividends	(13,402)	(5,925)	(3,390)
Purchase of treasury stock	(78,859)	(8,011)	(12,417)
Net cash provided (used) by financing activities	302,032	262,826	(89,395)
Decrease in cash and cash equivalents	(48,928)	(155,256)	(10,153)
Cash and cash equivalents at beginning of year	86,503	241,759	251,912
Cash and cash equivalents at end of year	\$ 37,575	\$ 86,503	\$ 241,759
<b>Supplemental information:</b>			
Interest paid on deposits	\$42,759	\$52,413	\$ 65,438
Income taxes paid	13,881	11,764	13,684
Loans transferred to foreclosed properties and repossessed assets	5,045	1,461	1,406
Issuance of management recognition plan shares	10,193	-	-

# **Bank Mutual Corporation and Subsidiaries**

## **Notes to Consolidated Financial Statements**

**December 31, 2004**

*(Dollars in Thousands, Except Per Share Amounts)*

### **1. Summary of Significant Accounting Policies**

#### **Organization**

From November 1, 2000 until October 29, 2003, Bank Mutual Corporation was an OTS chartered United States corporation which became the mid-tier holding company in the regulatory restructuring of Mutual Savings Bank, into mutual holding company form. Until October 29, 2003, Bank Mutual Bancorp, MHC (the "MHC"), a U.S.-chartered mutual holding company of which Mutual Savings Bank's depositors held all of the voting and membership rights, owned a majority of Bank Mutual Corporation's outstanding common stock.

On November 1, 2000, Bank Mutual Corporation also acquired First Northern Capital Corp., the parent of First Northern Savings Bank. On March 16, 2003, Mutual Savings Bank and First Northern Savings Bank combined to form a single OTS chartered savings bank subsidiary of Bank Mutual Corporation called Bank Mutual ("Bank Mutual" or the "Bank").

On October 29, 2003, Bank Mutual Corporation completed a conversion and reorganization from a mutual holding company form, established a new Wisconsin chartered Bank Mutual Corporation and, in effect, sold the MHC's interest in Bank Mutual Corporation to the public. Existing Bank Mutual Corporation shareholders exchanged each existing share for 3.6686 shares of the new Bank Mutual Corporation. The total number of shares issued and exchanged in the offering was 78,707,669 shares.

All share and per share numbers in these financial statements have been adjusted to reflect the full conversion transaction and related share exchange.

As used herein, the "Company" refers to Bank Mutual Corporation both before and after the full conversion transaction

#### **Business**

Bank Mutual is a federal savings bank offering a full range of financial services to customers who are primarily located in the state of Wisconsin. Bank Mutual is principally engaged in the business of attracting deposits from the general public and using such deposits to originate residential and commercial real estate loans, consumer loans, and commercial and industrial loans.

#### **Principles of Consolidation**

The consolidated financial statements include the accounts and transactions of the Company and its wholly owned subsidiaries. Bank Mutual has the following wholly owned subsidiaries: Lake Financial and Insurance Services, Mutual Investment Corporation, MC Development Ltd., and First Northern Investments Inc. Significant intercompany accounts and transactions have been eliminated in consolidation. Bank Mutual also has two 50% owned subsidiaries, Savings Financial Corporation, which is accounted for using the equity method, and Arrowood Development, LLC, which is consolidated into the financial statements.

# **Bank Mutual Corporation and Subsidiaries**

## **Notes to Consolidated Financial Statements**

**December 31, 2004**

*(Dollars in Thousands, Except Per Share Amounts)*

### **1. Summary of Significant Accounting Policies (continued)**

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the statement of financial condition and revenues and expenses for the period. Actual results could differ from those estimates.

#### **Cash and Cash Equivalents**

The Company considers federal funds sold and interest-bearing deposits that have original maturities of three months or less to be cash equivalents.

#### **Federal Home Loan Bank Stock**

Stock of the Federal Home Loan Bank ("FHLB") is owned due to regulatory requirements and carried at cost, which is its redeemable value.

#### **Investment and Mortgage-Related Securities Available-for-Sale**

Available-for-sale securities are stated at fair value, with the unrealized gains and losses, net of tax, reported as a separate component of equity.

The amortized cost of securities classified as available-for-sale is adjusted for amortization of premiums and accretion of discounts to maturity, or in the case of mortgage-related securities, over the estimated life of the security. Such amortization is included in interest income from investments. Interest and dividends are included in interest income from investments. Realized gains and losses and declines in value judged to be other-than-temporary are included in net gain or loss on sales of securities and are based on the specific identification method.

#### **Loans Held for Sale**

Loans held for sale, which generally consist of current production of certain fixed-rate mortgage loans, are recorded at the lower of cost or market value, determined on an individual loan basis. Fees received from the borrower are deferred and recorded as an adjustment of the carrying value.

#### **Loans Receivable and Related Interest Income**

Interest on loans is accrued and credited to income as earned. Accrual of interest is generally discontinued either when reasonable doubt exists as to the full, timely collection of interest or principal or when a loan becomes contractually past due by more than 90 days with respect to interest or principal. At that time, any accrued but uncollected interest is reversed and additional income is recorded only to the extent that payments are received and the collection of principal is reasonably assured. Loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time and the ultimate collectibility of the total contractual principal and interest is reasonably assured.

#### **Loan Fees and Related Costs**

Loan origination and commitment fees and certain direct loan origination costs are deferred and amortized as an adjustment of the related loans' yield. The Company amortizes these amounts using the level-yield method over the contractual life of the related loans.

# Bank Mutual Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

December 31, 2004

*(Dollars in Thousands, Except Per Share Amounts)*

### 1. Summary of Significant Accounting Policies (continued)

#### Allowance for Loan Losses

The allowance for loan losses is maintained at a level believed adequate by management to absorb probable losses inherent in the loan portfolio and is based on the size and current risk characteristics of the loan portfolio, an assessment of individual problem loans and actual loss experience, current economic events in specific industries and geographical areas, including unemployment levels, and other pertinent factors, including regulatory guidance and general economic conditions. Determination of the allowance is inherently subjective as it requires significant estimates, including the amounts and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends, all of which may be susceptible to significant change. Loan losses are charged off against the allowance, while recoveries of amounts previously charged off are credited to the allowance. A provision for loan losses is charged to operations based on management's periodic evaluation of the factors previously mentioned, as well as other pertinent factors. Evaluations are conducted at least quarterly and more often if deemed necessary.

#### Mortgage Servicing Rights

Mortgage servicing rights are recorded as an asset when loans are sold with servicing rights retained. The total cost of loans sold is allocated between the loan balance and the servicing asset based on their relative fair values. The total cost of loans sold is allocated between the loan balance and their servicing asset based on their relative fair values. The capitalized value of mortgage servicing rights is amortized in proportion to, and over the period of, estimated net future servicing revenue. Mortgage servicing rights are carried at the lower of the initial carrying value, adjusted for amortization, or estimated fair value. The carrying values are periodically evaluated for impairment. For purposes of measuring impairment, the servicing rights are stratified into pools based on term and interest rate. Impairment represents the excess of the remaining capitalized cost of a stratified pool over its fair value, and is recorded through a valuation allowance. The fair value of each servicing rights pool is calculated based on the present value of estimated future cash flows using a discount rate, given current market conditions. Estimates of fair value include assumptions about prepayment speeds, interest rates and other factors which are subject to change over time. Changes in these underlying assumptions could cause the fair value of mortgage servicing rights, and the related valuation allowance, if any, to change significantly in the future.

#### Mortgage Banking Loan Commitments

In connection with its mortgage banking activities, the Company enters into loan commitments to fund residential mortgage loans at specified interest rates and within specified periods of time, generally up to 60 days from the time of rate lock. A loan commitment whose loan arising from exercise of the loan commitment will be held for sale upon funding is a derivative instrument under Statement of Financial Accounting Standards No. 133 ("SFAS No. 133"), "Accounting for Derivative Instruments and Hedging Activities," (as amended), which must be recognized at fair value on the consolidated balance sheet in other assets and other liabilities with changes in its value recorded in income from mortgage banking operations.

In determining the fair value of its derivative loan commitments for economic purposes, the Company considers the value that would be generated when the loan arising from exercise of the loan commitment is sold in the secondary mortgage market. That value includes the price that the loan is expected to be sold for in the secondary mortgage market.

**Notes to Consolidated Financial Statements (Continued)**

**December 31, 2004**

*(Dollars in Thousands, Except Per Share Amounts)*

**1. Summary of Significant Accounting Policies (continued)**

**Foreclosed Properties and Repossessed Assets**

Foreclosed properties acquired through, or in lieu of, loan foreclosure are recorded at the lower of cost or fair value less estimated costs to sell. Costs related to the development and improvement of property are capitalized, whereas costs related to holding the property are expensed. Gains and losses on sales are recognized based on the carrying value upon closing of the sale.

**Premises and Equipment**

Land, buildings, leasehold improvements and equipment are carried at amortized cost. Buildings and equipment are depreciated over their estimated useful lives using the straight-line method. Leasehold improvements are amortized over the shorter of their useful lives or lease terms. The Company reviews buildings, leasehold improvements and equipment for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Impairment exists when the estimated undiscounted cash flows for the property are less than its carrying value. If identified, an impairment loss is recognized through a charge to earnings based on the fair value of the property.

**Goodwill and Other Intangible Assets**

Goodwill, representing the excess of purchase price over the fair value of net assets acquired, results from acquisitions made by the Company. Goodwill is reviewed at least annually for impairment based upon guidelines specified by Statement of Financial Accounting Standards ("SFAS") No. 142 - "Goodwill and Other Intangible Assets." Other intangible assets, primarily attributed to the customer relationships acquired, are amortized over their estimated useful lives, generally seven to fifteen years. Other intangible assets are reviewed if facts and circumstances indicate that they may be impaired. Prior to January 1, 2002, the Company amortized goodwill on a straight-line basis over periods of ten to twenty years and periodically assessed whether events or changes in circumstances indicated that the carrying amount of goodwill might be impaired.

**Life Insurance Policies**

Investments in life insurance policies owned by the Company are carried at the amount that could be realized under the insurance contract if the Company cashed them in on the respective dates.

**Income Taxes**

The Company files a consolidated federal income tax return and separate, or combined, state income tax returns, depending on the state. A deferred tax asset or liability is determined based on the enacted tax rates that will be in effect when the differences between the financial statement carrying amounts and tax basis of existing assets and liabilities are expected to be reported in the Company's income tax returns. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date of the change. A valuation allowance is provided for any deferred tax asset for which it is more likely than not that the asset will not be realized. Changes in valuation allowances are recorded as a component of income taxes.

# Bank Mutual Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

December 31, 2004

*(Dollars in Thousands, Except Per Share Amounts)*

### 1. Summary of Significant Accounting Policies (continued)

#### Earnings Per Share

Basic and diluted earnings per share ("EPS") are computed by dividing net income by the weighted-average number of common shares outstanding for the period. ESOP shares committed to be released are considered outstanding. Vested shares of restricted stock which have been awarded under the management recognition plan ("MRP") provisions of the Company's 2004 and 2001 Stock Incentive Plans, are considered common stock equivalents and are included in the weighted-average number of shares outstanding for basic EPS. Nonvested MRP shares are considered common stock equivalents and are included in the weighted-average number of shares outstanding for diluted EPS.

#### Pension Costs

The Company has both defined benefit and defined contribution plans. The Company's net periodic pension cost of the defined benefit plan consists of the expected cost of benefits earned by employees during the current period and an interest cost on the projected benefit obligation, reduced by the expected earnings on assets held by the retirement plan, amortization of transitional assets over a period of 15 years, amortization of prior service cost and amortization of recognized actuarial gains and losses over the estimated future service period of existing plan participants. The costs associated with the defined contribution plan consist of a predetermined percentage of compensation, which is determined by the Company's Board of Directors.

#### Segment Information

The Company has determined that it has one reportable segment – community banking. Bank Mutual offers a range of financial products and services to external customers, including: accepting deposits from the general public; originating residential, consumer and commercial loans; and marketing annuities and other insurance products.

#### Stock Compensation

In May 2001, the Company shareholders approved the 2001 Stock Incentive Plan (the "2001 Plan"), providing for restricted stock ("MRP") awards up to 1,226,977 shares. Of these, 1,210,630 MRP shares were granted during the year ended December 31, 2001 to employees in management positions and directors and 124,737 shares were subsequently forfeited. No shares were granted during the years ended December 31, 2002 and 2003. The outstanding 2001 MRP grants had a fair value of \$5,001 at December 31, 2004.

In May 2004, the Company shareholders approved the 2004 Stock Incentive Plan (the "2004 Plan"), providing for MRP awards up to 1,642,521 shares. Of these, 955,000 shares were granted during the year ended December 31, 2004. The outstanding 2004 MRP grants had a fair value of \$11,622 at December 31, 2004. The 2001 and 2004 MRP grants are being amortized to compensation expense as the Company's employees and directors become vested in the granted shares.

The amount amortized to expense was \$2,156 for the year ended December 31, 2004 and \$667 for the year ended December 31, 2003. The remaining unamortized cost of the MRP is reflected as a reduction of shareholders' equity as unearned deferred compensation.

Options for 4,050,122 shares were granted on May 8, 2001 under the 2001 Plan at an exercise price of \$3.2056 and expire on May 8, 2011. On May 3, 2004, options for an additional 2,382,000 shares were granted under the 2004 Plan at an exercise price of \$10.673 per share and expire May 3, 2014.

# Bank Mutual Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

December 31, 2004

(Dollars in Thousands, Except Per Share Amounts)

### 1. Summary of Significant Accounting Policies (continued)

The following schedule reflects stock options for the years ended December 31, 2004, 2003 and 2002.

	For the Year Ended December 31					
	2004		2003		2002	
	Stock Options	Weighted Avg. Cost	Stock Options	Weighted Avg. Cost	Stock Options	Weighted Avg. Cost
Outstanding at beginning of year	3,298,590	\$ 3.2056	3,819,346	\$3.2056	4,013,436	\$3.2056
Granted	2,382,000	\$10.6730	-	-	-	-
Exercised	403,637	\$ 3.2056	368,143	\$3.2056	147,132	\$3.2056
Forfeited	-	-	152,613	\$3.2056	46,958	\$3.2056
Outstanding at end of year	<u>5,276,953</u>	<u>\$ 6.5760</u>	<u>3,298,590</u>	<u>\$3.2056</u>	<u>3,819,346</u>	<u>\$3.2056</u>

At December 31, 2004				
Price	Unexercisable Stock Options		Exercisable Stock Options	
	Shares	Remaining Contractual Life	Shares	Exercise Price
\$ 3.2056	1,420,495	6.4 years	1,474,458	\$3.2056
\$10.6730	2,382,000	9.3 years		

The estimated fair value of each option granted is calculated using the Black-Scholes option-pricing model. The following summarizes the weighted average assumptions used in the model:

	2004	2003	2002
Risk-free interest rate	4.81 - 5.30%	5.30%	5.30%
Dividend yield	2.00%	2.00%	2.00%
Expected stock volatility	11.76 - 26.30%	26.30%	26.30%
Expected years until exercise	5.00 - 9.25	6.00	7.00

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. Option valuation models such as the Black-Scholes require the input of highly subjective assumptions including the expected stock price volatility. Bank Mutual's stock options have characteristics significantly different from traded options and inasmuch, changes in the subjective input assumptions can materially affect the fair value estimate. In management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its stock options.

# Bank Mutual Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

December 31, 2004

(Dollars in Thousands, Except Per Share Amounts)

### 1. Summary of Significant Accounting Policies (continued)

The Company accounts for the stock options in accordance with APB Opinion 25, as allowed under SFAS No. 123, and, therefore, no compensation cost has been recognized in connection with stock options granted in any year. Pursuant to SFAS No. 123 disclosure requirements, pro forma net income and earnings per share are presented below as if compensation cost for stock options was determined under the fair value method and amortized to expense over the options' vesting periods.

	Year Ended December 31		
	2004	2003	2002
Net income:			
As reported	\$29,554	\$22,599	\$26,545
Pro forma	\$28,689	\$21,880	\$25,826
Basic earnings per share:			
As reported	\$0.39	\$0.30	\$0.34
Pro forma	\$0.38	\$0.29	\$0.33
Diluted earnings per share:			
As reported	\$0.38	\$0.29	\$0.34
Pro forma	\$0.37	\$0.28	\$0.32

The pro forma amounts may not be indicative of the effect on reported net income and earnings per share for future years as current options vest over five years.

### Recent Accounting Changes

In January 2003, the Financial Accounting Standards Board ("FASB") issued Financial Interpretation Number ("FIN") 46. FIN 46 required the consolidation of entities in which an enterprise absorbs a majority of the entity's expected losses, receives a majority of the entity's expected residual returns, or both, as a result of ownership, contractual or other financial interest in the entity. The provisions of this statement were effective immediately for variable interests in variable interest entities ("VIE's") created after January 31, 2003. The Corporation adopted FIN 46 for the quarter ended December 31, 2003.

Management has evaluated the applicability of FIN 46 on various investments and interests, including low-income housing partnership interests, small business commercial real estate partnerships and historic tax credit partnerships. The Company has determined as of December 31, 2003, that it did not have any VIEs. In 2004, a partnership, which is 50% owned by the Company, was established to develop 318 acres of owned real estate with an unrelated third party, which is classified as a VIE. This VIE is recorded on the statement of financial condition as an increase in other assets (\$2.3 million) and is accompanied by an increase in minority interest in real estate development as a mezzanine item, after liabilities and before shareholders' equity. The income and expenses of the partnership are presented in other income and expenses are presented in other expenses of the statement of income.



**Notes to Consolidated Financial Statements (Continued)**

**December 31, 2004**

*(Dollars in Thousands, Except Per Share Amounts)*

**1. Summary of Significant Accounting Policies (continued)**

Securities and Exchange Commission ("SEC") Staff Accounting Bulletin ("SAB") No. 105, "Application of Accounting Principles to Loan Commitments" was issued on March 9, 2004 and is effective for commitments to originate mortgage loans to be held for sale that are entered into after March 31, 2004. SAB No. 105 requires that fair-value measurement include only differences between the guaranteed interest rate in the loan commitment and a market interest rate, excluding expected future cash flows related to the customers relationship or loan servicing. Because of the SAB's limit on the types of cash flows that can be considered in the fair-value measurement, mortgage-loan commitments could be recognized as liabilities if the guaranteed rate in the commitment is less than the market interest rate. In addition, SAB No. 105 requires registrants to disclose their accounting policy for loan commitments pursuant to APB Opinion No. 22, including methods and assumptions used to estimate fair value and any associated hedging strategies, as required by Statement No. 107, Statement No. 133 and Item No. 305 of Regulation S-K (Quantitative and Qualitative Disclosures About Market Risk). The provisions of SAB No. 105 must be applied to loan commitments accounted for as derivatives that are entered into after March 31, 2004. This SAB had minimal impact on our financial condition or the results of operations.

The FASB Emerging Issues Task Force ("EITF") issued EITF No. 03-01 "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" to provide guidance on certain accounting issues. Specifically, it provided guidance to better define when and whether unrealized losses in the investment category of "Available-for-Sale" should be deemed other than temporary and if the unrealized losses are other than temporary requiring immediate recognition through the statement of income. In September 2004, FASB, after receiving input from businesses, delayed the implementation of certain aspects of the issue which addresses the determination of other-than-temporary issues and will reconsider in its entirety the EITF and all other guidance on disclosing, measuring and recognizing other-than-temporary impairments of debt and equity securities.

On December 16, 2004, FASB issued SFAS No. 123 ("R"evised 2004), "Share-Based Payment," which is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS No. 123(R) supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees," and amends SFAS No. 95, "Statement of Cash Flows." Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. We expect to adopt SFAS No. 123(R) on July 1, 2005.

As permitted by SFAS No. 123, the Company currently accounts for share-based payments to employees using APB 25's intrinsic value method and, as such, generally recognizes no compensation cost for employee stock options. Accordingly, the adoption of SFAS No. 123(R)'s fair value method will have an impact on our results of operations, although it will have no material impact on our overall financial position. The impact of adoption of SFAS No. 123(R) cannot be predicted at this time because it will depend on levels of share-based payments granted in the future. However, had we adopted SFAS No. 123(R) in prior periods, the impact of that standard would have approximated the impact of SFAS No. 123 as described in the disclosure of pro forma net income and earnings per share in "Note 1. Summary of Significant Accounting Policies...Stock Compensation" to our consolidated financial statements. SFAS No. 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption. While the Company cannot estimate what those amounts will be in the future (because they depend on, among other things, when employees exercise stock options), the amount of operating cash flows recognized in prior periods for such excess tax deductions were not material to the cash flows of the Company.

**Reclassifications**

Certain 2003 and 2002 amounts have been reclassified to conform to the 2004 presentation.

# Bank Mutual Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

December 31, 2004

(Dollars in Thousands, Except Per Share Amounts)

### 2. Securities, Available-for-Sale

The amortized cost and fair value of investment securities available-for-sale are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
At December 31, 2004:				
Investment securities:				
U.S. government and federal agency obligations	\$ 19,967	\$ 46	\$ (182)	\$ 19,831
Mutual funds	46,018	12	(640)	45,390
Stock in federal agencies	1,461	2,071	—	3,532
Total investment securities	67,446	2,129	(822)	68,753
Mortgage-related securities:				
Federal Home Loan Mortgage Corporation	635,806	1,525	(6,307)	631,024
Federal National Mortgage Association	544,928	2,709	(4,834)	542,803
Private Placement CMOs	9,928	—	—	9,928
Government National Mortgage Association	82,635	111	(277)	82,469
Total mortgage-related securities	1,273,297	4,345	(11,418)	1,266,224
Total	\$1,340,743	\$6,474	\$(12,240)	\$1,334,977

The following schedule identifies securities by time in which the securities had a gross unrealized loss.

	Less than 12 months In an unrealized loss position			Greater than 12 months In an unrealized loss position			Total Unrealized Loss Amount	Total Estimated Fair Value
	Unrealized Loss Amount	Number of Securities	Estimated Fair Value	Unrealized Loss Amount	Number of Securities	Estimated Fair Value		
Investment securities:								
U.S. government and federal agency obligations								
Corporate issue obligations	\$ (89)	1	\$ 7,630	\$ (93)	2	\$ 6,907	\$ (182)	\$ 14,537
Mutual funds	—	—	—	(640)	2	44,707	(640)	44,707
Stock in federal agencies	—	—	—	—	—	—	—	—
Total investment securities	(89)	1	7,630	(733)	4	51,614	(822)	59,244
Mortgage-related securities:								
Federal Home Loan Mortgage Corporation	(3,827)	47	294,753	(2,480)	36	129,105	(6,307)	423,858
Federal National Mortgage Association	(1,498)	37	227,989	(3,336)	38	182,415	(4,834)	410,404
Government National Mortgage Association	(71)	4	31,789	(206)	5	37,877	(277)	69,666
Total mortgage-related securities	(5,396)	88	554,531	(6,022)	79	349,397	(11,418)	903,928
Total	\$(5,485)	89	\$562,161	\$(6,755)	83	\$401,011	\$(12,240)	\$963,172

The Company does not believe any individual unrealized loss as of December 31, 2004 represents an other-than-temporary impairment. The unrealized losses reported for mortgage-backed securities relate primarily to securities issued by FNMA, FHLMC and private institutions. These unrealized losses are primarily attributable to changes in interest rates and individually were 2% or less of their respective amortized cost basis. The Company has the ability to hold the securities contained in the previous table for a time necessary to recover the amortized cost.

# Bank Mutual Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

December 31, 2004

(Dollars in Thousands, Except Per Share Amounts)

### 2. Securities, Available-for-Sale (continued)

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
At December 31, 2003:				
Investment securities:				
U.S. government and federal agency obligations	\$ 21,434	\$ 352	\$ (50)	\$ 21,736
Mutual funds	45,051	20	(374)	44,697
Stock in federal agencies	1,461	-	(40)	1,421
Total investment securities	67,946	372	(464)	67,854
Mortgage-related securities:				
Federal Home Loan Mortgage Corporation	518,893	3,053	(3,774)	518,172
Federal National Mortgage Association	444,167	4,700	(3,371)	445,496
Private Placement CMOs	537	6	-	543
Government National Mortgage Association	89,589	322	(773)	89,138
Total mortgage-related securities	1,053,186	8,081	(7,918)	1,053,349
Total	\$1,121,132	\$8,453	\$ (8,382)	\$1,121,203

The amortized cost and fair values of securities by contractual maturity at December 31, 2004, are shown below. Actual maturities may differ from contractual maturities because issuers have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
Due in one year or less	\$ 5,248	\$ 5,294
Due after one year through five years	14,719	14,537
Due after five years through ten years	-	-
Mutual funds	46,018	45,390
Stock in Federal Agencies	1,461	3,532
Mortgage-related securities	1,273,297	1,266,224
	<u>\$1,340,743</u>	<u>\$1,334,977</u>

The following table summarizes the adjustment to other comprehensive income and the related tax effect for each of the three years ended December 31:

	2004	2003	2002
Change in unrealized holding gain (loss) on available-for-sale securities during the period			
Unrealized net gains (losses)	\$(5,837)	\$(16,070)	\$7,071
Related tax expense (benefit)	(2,036)	(5,809)	2,596
	<u>(3,801)</u>	<u>(10,261)</u>	<u>4,475</u>
Less: Reclassification adjustment for gains included in income			
Related gains on available-for-sale securities	-	121	9
Related tax expense	-	44	3
	<u>-</u>	<u>77</u>	<u>6</u>
Change in other comprehensive income	<u>\$(3,801)</u>	<u>\$(10,338)</u>	<u>\$4,469</u>

# Bank Mutual Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

December 31, 2004

(Dollars in Thousands, Except Per Share Amounts)

### 2. Securities, Available-for-Sale (continued)

Investment securities with a fair value of approximately \$133,518 and \$14,048 at December 31, 2004 and 2003, were pledged to secure deposits, borrowings and for other purposes as permitted or required by law. See also Notes 6 and 11 for additional information regarding security pledges.

### 3. Loans Receivable

Loans receivable consist of the following:

	December 31	
	2004	2003
Mortgage loans:		
One-to-four family	\$ 903,498	\$ 793,247
Multifamily	161,641	124,494
Commercial real estate	195,708	209,293
Construction and development	141,394	122,436
Total mortgage real estate loans	1,402,241	1,249,470
Consumer and other loans:		
Fixed equity	266,635	252,550
Home equity lines of credit	88,444	78,567
Student	20,519	20,546
Home improvement	24,293	12,605
Automobile	61,469	67,630
Other	15,911	18,623
Total consumer and other loans	477,271	450,521
Total commercial business loans	70,170	75,022
Total loans receivable	1,949,682	1,775,013
Less:		
Undisbursed loan proceeds	60,653	47,743
Allowance for loan losses	13,923	13,771
Unearned loan fees and discounts	(779)	1,221
	73,797	62,735
Total loans receivable – net	\$1,875,885	\$1,712,278

The Company's first mortgage loans and home equity lines of credit are primarily secured by properties housing one-to-four families which are generally located in the Company's local lending areas in Wisconsin, Michigan and Minnesota. Non-accrual loans at December 31, 2004 were \$5,683 and at December 31, 2003, were \$9,288.

A summary of the activity in the allowance for loan losses follows:

	Year ended December 31		
	2004	2003	2002
Balance at beginning of year	\$13,771	\$12,743	\$12,245
Provisions	1,330	1,304	760
Charge-offs	(1,253)	(501)	(481)
Recoveries	75	225	219
Balance at end of year	\$13,923	\$13,771	\$12,743

The unpaid principal balance of loans serviced for others was \$620,055, \$649,332, and \$638,801 at December 31, 2004, 2003 and 2002, respectively. These loans are not reflected in the consolidated financial statements.

# Bank Mutual Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

December 31, 2004

(Dollars in Thousands, Except Per Share Amounts)

### 3. Loans Receivable (continued)

The following table presents data on impaired loans:

	December 31	
	2004	2003
Impaired loans for which an allowance has been provided	\$7,153	\$16,254
Impaired loans for which no allowance has been provided	1,503	738
Total loans determined to be impaired	\$8,656	\$16,992
Allowance for loan losses related to impaired loans	\$3,524	\$ 3,477

	Year ended December 31		
	2004	2003	2002
Average recorded investment in impaired loans	\$8,706,263	\$9,396,890	\$ -
Cash basis interest income recognized from impaired loans	\$ 293,073	\$408,617	\$ -

### 4. Goodwill, Other Intangible Assets and Mortgage Servicing Rights

The carrying amount of mortgage servicing rights net of accumulated amortization and the associated valuation allowance at December 31, 2004 is presented in the following table.

	2004	2003	2002
Mortgage servicing rights at beginning of year	\$ 4,698	\$ 6,149	\$4,738
Additions	1,529	4,480	3,251
Amortization	(1,685)	(5,931)	(1,840)
Mortgage servicing rights at end of year	4,542	4,698	6,149
Valuation allowance	-	-	(3,089)
Balance	\$ 4,542	\$ 4,698	\$3,060

In 2004, there were no permanent impairments, however in 2003, a charge of \$1,419 was recorded for loans that had mortgage servicing rights that were permanently impaired. This amount is included with the amortization in the table above.

Deposit base intangibles had a carrying amount and a value net of accumulated amortization of \$4,412 at December 31, 2004.

# Bank Mutual Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

December 31, 2004

(Dollars in Thousands, Except Per Share Amounts)

### 4. Goodwill, Other Intangible Assets and Mortgage Servicing Rights (continued)

The projections of amortization expense shown below for mortgage servicing rights are based on existing asset balances and the existing interest rate environment as of December 31, 2004. Future amortization expense may be significantly different depending upon changes in the mortgage servicing portfolio, mortgage interest rates and market conditions.

The following table shows the current period and estimated future amortization expense for amortizable intangible assets:

	Mortgage Servicing Rights	Deposit Base Intangibles	Total
Twelve months ended December 31, 2004 (actual)	\$1,685	\$ 661	\$2,346
Estimate for year ending December 31,			
2005	\$ 979	\$ 661	\$1,640
2006	978	661	1,639
2007	974	661	1,635
2008	949	618	1,567
2009	554	405	959
Thereafter	108	1,406	1,514
	<u>\$4,542</u>	<u>\$4,412</u>	<u>\$8,954</u>

### 5. Other Assets

Other Assets are summarized as follows:

	December 31	
	2004	2003
Accrued interest:		
Mortgage-related securities	\$ 4,581	\$ 4,034
Investment securities	172	200
Loans receivable	6,599	6,586
Total accrued interest	11,352	10,820
Foreclosed properties and repossessed assets	1,621	630
Premises and equipment	43,966	45,196
Federal Home Loan Bank stock, at cost	38,186	35,498
Bank owned life insurance	19,324	18,268
Other	15,902	11,734
	<u>\$130,351</u>	<u>\$122,146</u>

# Bank Mutual Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

December 31, 2004

(Dollars in Thousands, Except Per Share Amounts)

### 5. Other Assets (continued)

Foreclosed properties and repossessed assets are summarized as follows:

	December 31	
	2004	2003
Acquired by foreclosure or in lieu of foreclosure	\$1,589	\$529
Repossessed collateral	32	101
	<u>\$1,621</u>	<u>\$630</u>

Premises and equipment are summarized as follows:

	December 31	
	2004	2003
Land and land improvements	\$12,478	\$12,748
Office buildings	41,342	40,139
Furniture and equipment	15,979	15,547
Leasehold improvements	929	1,093
	<u>70,728</u>	<u>69,527</u>
Less allowances for depreciation and amortization	26,762	24,331
	<u>\$43,966</u>	<u>\$45,196</u>

Depreciation expense for 2004, 2003 and 2002 was \$3,253, \$3,021 and \$2,811, respectively.

Bank Mutual leases various branch offices, office facilities and equipment under noncancelable operating leases which expire on various dates through 2012. Future minimum payments under noncancelable operating leases with initial or remaining terms of one year or more for the years indicated are as follows at December 31, 2004:

2005	\$1,142
2006	877
2007	739
2008	724
2009	499
Thereafter	455
Total	<u>\$4,436</u>

Rental expenses totaled \$999, \$974, and \$1,022 for 2004, 2003 and 2002, respectively.

# Bank Mutual Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

December 31, 2004

(Dollars in Thousands, Except Per Share Amounts)

### 6. Deposits

Deposits are summarized as follows:

	December 31	
	2004	2003
Checking accounts:		
Noninterest-bearing	\$ 111,855	\$ 110,099
Interest-bearing	171,565	157,231
	<u>283,420</u>	<u>267,330</u>
Money market accounts	309,531	358,003
Savings accounts	247,439	240,543
Certificate accounts:		
Due within one year	584,172	510,195
After one but within two years	241,059	318,652
After two but within three years	225,987	140,604
After three but within four years	30,636	192,203
After four but within five years	60,637	24,760
After five years	-	-
	<u>1,142,491</u>	<u>1,186,414</u>
	<u>\$1,982,881</u>	<u>\$2,052,290</u>

The aggregate amount of certificate accounts with balances of one hundred thousand dollars or more is approximately \$155,117 and \$149,690 at December 31, 2004 and 2003, respectively.

Interest expense on deposits was as follows:

	Year ended December 31		
	2004	2003	2002
Interest-bearing checking accounts	\$ 359	\$ 416	\$ 833
Money market accounts	3,301	4,353	6,673
Savings accounts	1,084	1,490	2,402
Certificate accounts	37,373	45,160	54,983
	<u>\$42,117</u>	<u>\$51,419</u>	<u>\$64,891</u>



# Bank Mutual Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

December 31, 2004

(Dollars in Thousands, Except Per Share Amounts)

### 7. Borrowings

Borrowings consist of the following:

	December 31			
	2004		2003	
	Balance	Weighted-Average Rate	Balance	Weighted-Average Rate
Federal Home Loan Bank advances maturing:				
2004	\$ -	-%	\$231,775	5.61%
2005	168,010	2.43	17,996	5.20
2006	407,955	2.80	7,948	4.85
2007	-	-	-	-
2008	1,025	5.90	1,024	5.90
2009	-	-	-	-
Thereafter	46,935	5.22	40,748	5.23
Open-line of credit	137,600	2.47	-	-
Other borrowings	-	-	-	-
	<u>\$761,525</u>		<u>\$299,491</u>	

Bank Mutual is required to maintain unencumbered mortgage loans in its portfolios aggregating at least 167% of the amount of outstanding advances from the FHLB as collateral. Bank Mutual's borrowings at the FHLB are limited to the lesser of 35% of total assets or 60% of the book value of certain mortgage loans. In addition, these notes are collateralized by FHLB stock of \$38,186 and \$35,498 at December 31, 2004 and 2003, respectively.

Bank Mutual has a line of credit with two financial institutions which totals \$10.0 million. At December 31, 2004 and 2003, no draws were outstanding.

### 8. Shareholders' Equity

Bank Mutual is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possible additional discretionary, actions by regulators, that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, Bank Mutual must meet specific capital guidelines that involve quantitative measures of Bank Mutual's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. Bank Mutual's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

# Bank Mutual Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

December 31, 2004

(Dollars in Thousands, Except Per Share Amounts)

### 8. Shareholders' Equity (continued)

Quantitative measures established by federal regulation to ensure adequacy require Bank Mutual to maintain minimum amounts and ratios (set forth in the following table) of total and Tier I capital (as these terms are defined in regulations) to risk-weighted assets (as these terms are defined in regulations), and of Tier I capital (as these terms are defined in regulations) to average assets (as these terms are defined in regulations). Management believes, as of December 31, 2004, that Bank Mutual met all capital adequacy requirements.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Bank Mutual						
As of December 31, 2004:						
Total capital	\$479,279	28.85%	\$132,895	8.00%	\$166,119	10.00%
(to risk-weighted assets)						
Tier 1 capital	465,356	28.01	66,447	4.00	99,671	6.00
(to risk-weighted assets)						
Tier 1 capital	465,356	13.74	135,504	4.00	169,380	5.00
(to average assets)						
Bank Mutual						
As of December 31, 2003:						
Total capital						
(to risk-weighted assets)	\$463,569	30.08%	\$123,285	8.00%	\$154,107	10.00%
Tier 1 capital						
(to risk-weighted assets)	451,660	29.31	61,643	4.00	92,464	6.00
Tier 1 capital						
(to average assets)	451,660	14.82	121,900	4.00	152,375	5.00

The Company is not aware of any conditions or events, which would change Bank Mutual's status as well capitalized. There are no conditions or events since that notification that management believes have changed Bank Mutual's category.

# Bank Mutual Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

December 31, 2004

(Dollars in Thousands, Except Per Share Amounts)

### 8. Shareholders' Equity (continued)

Following are reconciliations of Bank Mutual's (subsidiary bank) equity under generally accepted accounting principles to capital as determined by regulators:

	Bank Mutual	
	Risk-Based Capital	Tier I (Core) Capital
As of December 31, 2004:		
Equity per bank records	\$519,548	\$519,548
Unrealized gains on investments	4,844	4,844
Goodwill and intangibles	(55,214)	(55,214)
Investment in "nonincludable" subsidiaries	(3,550)	(3,550)
Disallowed servicing assets	(272)	(272)
Equity investments required to be deducted	-	-
Allowance for loan losses	13,923	-
Regulatory capital	<u>\$479,279</u>	<u>\$465,356</u>

### 9. Earnings Per Share

The computation of the Company's basic and diluted earnings per share is presented in the following table.

	Year ended December 31		
	2004	2003	2002
<b>Basic earnings per share</b>			
Net income	<u>\$29,554</u>	<u>\$22,599</u>	<u>\$26,545</u>
Weighted average shares outstanding	74,672,199	75,779,184	77,024,851
Allocated ESOP shares for the period	327,194	327,194	327,195
Vested MRP shares for the period	328,384	223,141	240,587
	<u>75,327,777</u>	<u>76,329,519</u>	<u>77,592,633</u>
Basic earnings per share	<u>\$0.39</u>	<u>\$0.30</u>	<u>\$0.34</u>
<b>Diluted earnings per share</b>			
Net income	<u>\$29,554</u>	<u>\$22,599</u>	<u>\$26,545</u>
Weighted average shares outstanding used in basic earnings per share	75,327,777	76,329,519	77,592,633
Net dilutive effect of:			
Stock option shares	1,958,592	1,884,239	1,294,961
Unvested MRP shares	292,133	353,992	278,571
	<u>77,578,502</u>	<u>78,567,750</u>	<u>79,166,165</u>
Diluted earnings per share	<u>\$0.38</u>	<u>\$0.29</u>	<u>\$0.34</u>

# Bank Mutual Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

December 31, 2004

(Dollars in Thousands, Except Per Share Amounts)

### 10. Employee Benefit Plans

#### Bank Mutual Corporation

Bank Mutual Corporation has a discretionary, defined contribution savings plan (the Savings Plan). The Savings Plan is qualified under Sections 401 and 401(k) of the Internal Revenue Code and provides employees meeting certain minimum age and service requirements the ability to make contributions to the Savings Plan on a pretax basis. The Company then matches a percentage of the employee's contributions. Matching contributions made by the Company were \$159 in 2004, \$146 in 2003 and \$103 in 2002.

Bank Mutual Corporation also has a defined benefit pension plan covering employees meeting certain minimum age and service requirements and a supplemental pension plan for certain qualifying employees. The supplemental pension plan is funded through a "rabbi trust" arrangement. The benefits are generally based on years of service and the employee's average annual compensation for five consecutive calendar years in the last ten calendar years which produces the highest average. The Company's funding policy is to contribute annually the amount necessary to satisfy the requirements of the Employee Retirement Income Security Act of 1974. As of January 1, 2002, First Northern Savings Bank employees meeting certain minimum age and service requirements entered the defined benefit plan; for those First Northern Savings Bank employees, only years of service after that date are counted for funding. However, for vesting purposes, First Northern Savings Bank employees received credit under the defined benefit plan for their years of service since joining First Northern Savings Bank.

The following tables set forth the defined benefit pension plan's funded status and net periodic benefit cost:

	2004	2003
<b>Change in Benefit Obligation</b>		
Benefit obligation at beginning of year	\$22,596	\$18,982
Service cost	1,659	1,419
Interest cost	1,394	1,260
Actuarial loss	1,845	1,334
Benefits paid	(419)	(399)
Benefit obligation at end of year	\$27,075	\$22,596
<b>Change in Plan Assets</b>		
Fair value of plan assets at beginning of year	\$24,188	\$21,070
Actual return on plan assets	2,011	1,567
Employer contributions	3,351	1,950
Benefits paid	(419)	(399)
Fair value of plan assets at end of year	\$29,131	\$24,188
<b>Funded Status</b>		
Funded status at end of year	\$2,056	\$1,592
Unrecognized net actuarial loss	1,151	(248)
Unamortized prior service cost	334	462
Unrecognized additional liability	(2,187)	-
Prepaid benefit cost	\$1,354	\$1,806
<b>Amount Recognized in the Statement of Financial Position Consists of:</b>		
Prepaid benefit cost	\$ 3,347	\$1,806
Intangible assets	194	-
Accumulated other comprehensive income	(2,187)	-
Net amount recognized	\$ 1,354	\$1,806

# Bank Mutual Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

December 31, 2004

(Dollars in Thousands, Except Per Share Amounts)

### 10. Employee Benefit Plans (continued)

#### Accumulated Benefit Obligations

The accumulated benefit obligations for the defined benefit pension plan was \$27,075 and \$22,596 at October 31, 2004 and 2003, respectively.

Weighted-average assumptions used in cost calculations:

Discount rate	6.00%	6.25%
Rate of increase in compensation levels	4.00%	4.00%
Expected long-term rate of return on plan assets	7.00%	7.00%

The expected long-term rate of return was estimated using a combination of the expected rate of return for immediate participation contracts and the historical rate of return for immediate participation contracts.

	2004	2003	2002
<b>Components of Net Periodic Benefit Cost</b>			
Service cost	\$1,659	\$1,419	\$1,251
Interest cost	1,394	1,260	1,163
Expected return on plan assets	(2,011)	(1,567)	(1,266)
Amortization of prior service cost	128	129	129
Recognized actuarial loss (gain)	-	-	(4)
Amortization of gain from prior periods	107	(42)	(68)
Asset gain	339	114	-
Total net periodic benefit cost	<u>\$1,616</u>	<u>\$1,313</u>	<u>\$1,205</u>

Pension plan assets which consist primarily of immediate participation guarantee contracts with an insurance company are actively managed by investment professionals.

The Company projects the following benefit payments under the various retirement plans.

Year	Projected Benefit Payments
2005	\$ 900
2006	980
2007	1,167
2008	1,713
2008	1,854
2010 - 2014	12,021
	<u>\$18,635</u>

# Bank Mutual Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

December 31, 2004

(Dollars in Thousands, Except Per Share Amounts)

### 10. Employee Benefit Plans (continued)

The Company values its pension plan annually at October 31. The pension plan weighted-average asset allocations at October 31, 2004 and 2003, by asset category are as follows:

Asset Category	At October 31	
	2004	2003
Equity Securities	4.8%	3.7%
Debt securities	14.1	16.8
Immediate participation guarantee contracts	81.1	79.5
Total	100.0%	100.0%

### Investment Policy

The investment objective is to minimize risk. Asset allocation strongly favors immediate participation contracts with an Insurance Company. The equity securities are shares of stock issued by the insurance company when it demutualized.

### Contributions

The amount of the 2005 contribution will be determined based on a number of factors, including the results of the Actuarial Valuation Report as of January 1, 2005. At this time, the amount of the 2005 contribution is not known.

### Bank Mutual

Bank Mutual has a deferred retirement plan, which was formerly a Mutual Savings Bank plan, for non-officer directors who have provided at least five years of service. Four of the five existing eligible directors' benefits have vested. In the event a director dies prior to completion of these payments, payments will go to the director's heirs. Bank Mutual has funded these arrangements through "rabbi trust" arrangements, and based on actuarial analyses believes these obligations are adequately funded.

First Northern Savings Bank also had supplemental retirement plans for several executives. Total expense relating to these plans for the year ended December 31, 2004 and 2003 was \$140 and \$153, respectively.

# Bank Mutual Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

December 31, 2004

(Dollars in Thousands, Except Per Share Amounts)

### 11. Stock-Based Benefit Plans

The Company established an ESOP for the employees of the Company and Bank Mutual. The ESOP is a qualifying plan under Internal Revenue Service guidelines. It covers all full-time employees who have attained at least 21 years of age and completed one year of service. At November 1, 2000, the ESOP borrowed \$609 from the Company and purchased 223,454 shares of common stock issued in the public offering. Subsequent to this initial purchase, through December 31, 2000, the ESOP borrowed an additional \$8,362 and purchased an additional 3,037,600 shares. In January 2001, the ESOP bought an additional 10,892 shares. Expense is recognized based on the fair value (average stock price) of shares scheduled to be released from the ESOP trust. One-tenth of the shares are scheduled to be released each year, which started in 2001. Also, additional shares may be released as the ESOP Trust receives cash dividends from the unallocated shares held in the Trust. In 2002, such additional shares were released. ESOP expense for the year ended December 31, 2004 was \$3,695; for the year ended December 31, 2003 was \$2,950; and for the year ended December 31, 2002 was \$2,414.

The following table summarizes shares of Company common stock held by the ESOP at December 31.

	2004	2003	2002
Shares allocated to participants	327,194	327,194	436,960
Unallocated and unearned shares	1,762,614	2,089,808	2,417,002
Fair value of unearned ESOP shares	\$ 21,451	\$ 23,803	\$ 15,236

### 12. Income Taxes

The provision for income taxes consists of the following:

	Year ended December 31		
	2004	2003	2002
Current:			
Federal	\$14,269	\$10,030	\$13,703
State	400	415	(43)
	14,669	10,445	13,660
Deferred expense (benefit):			
Federal	976	1,520	(895)
State	(13)	(270)	191
	963	1,250	(704)
	\$15,632	\$11,695	\$12,956

For state income tax purposes, certain subsidiaries have net operating loss carryovers of \$15,418 available to offset against future income. The carryovers expire in the years 2005 through 2019 if unused.

# Bank Mutual Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

December 31, 2004

(Dollars in Thousands, Except Per Share Amounts)

### 12. Income Taxes (continued)

The income tax provision differs from the provision computed at the federal statutory corporate rate as follows:

	Year ended December 31		
	2004	2003	2002
Income before provision for income taxes	\$45,186	\$34,294	\$39,501
Tax expense at federal statutory rate	\$15,815	\$12,003	\$13,825
Increase (decrease) in taxes resulting from:			
State income taxes – net of federal tax benefit	291	117	(521)
Bank Owned Life insurance	(382)	(432)	(317)
Other	(92)	7	(31)
Provision for income taxes	\$15,632	\$11,695	\$12,956

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

The significant components of the Company's deferred tax assets and liabilities are summarized as follows:

	December 31	
	2004	2003
Deferred tax assets:		
State net operating losses	\$ 863	\$ 763
Loan loss reserves	5,578	5,612
Pension	3,235	2,289
Deferred compensation	1,445	936
Unrealized gain on investment securities	2,117	79
Total deferred tax assets	13,238	9,679
Valuation allowance	(414)	(409)
Net deferred tax assets	12,824	9,270
Deferred tax liabilities:		
Property and equipment depreciation	1,227	2,235
FHLB stock dividends	4,578	3,174
Deferred loan fees	1,675	633
Purchase accounting adjustments	5,358	5,615
Other	1,034	871
Total deferred tax liabilities	13,872	12,528
Net deferred tax liability	\$(1,048)	\$(3,258)



# Bank Mutual Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

December 31, 2004

(Dollars in Thousands, Except Per Share Amounts)

### 13. Financial Instruments with Off-Balance-Sheet Risk

The Company is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments consist of commitments to extend credit and involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the consolidated statements of financial condition. The contract amounts reflect the extent of involvement the Company has in particular classes of financial instruments and also represents the Company's maximum exposure to credit loss.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and generally require payment of a fee. As some commitments expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates the collateral needed and creditworthiness of each customer on a case by case basis. The Company generally extends credit only on a secured basis. Collateral obtained varies, but consists principally of one-to-four family residences.

Financial instruments whose contract amounts represent credit risk are as follows:

	December 31	
	2004	2003
Unused consumer lines of credit	\$154,213	\$153,068
Unused commercial lines of credit	22,261	12,919
Commitments to extend credit:		
Fixed rate	16,550	17,115
Adjustable rate	57,289	35,838
Credit enhancement under the Federal Home Loan Bank of Chicago Mortgage Partnership Finance program	1	3

Forward commitments to sell mortgage loans of \$10,545 at December 31, 2004, represent commitments obtained by the Company from a secondary market agency to purchase mortgages from the Company. Commitments to sell loans expose Bank Mutual to interest rate risk if market rates of interest decrease during the commitment period. Commitments to sell loans are made to mitigate interest rate risk on commitments to originate loans and loans held for sale. Forward commitments at December 31, 2003 were \$8,315.

The Company participates in the FHLB Mortgage Partnership Finance Program (the "Program"). In addition to entering into forward commitments to sell mortgage loans to a secondary market agency, the Company enters into firm commitments to deliver loans to the FHLB through the Program. Under the Program, loans are funded by the FHLB and the Company receives an agency fee reported as a component of gain on sale of loans. The Company had no firm commitments outstanding to deliver loans through the Program at December 31, 2004. Once delivered to the Program, the Company provides a contractually agreed-upon credit enhancement and performs servicing of the loans. Under the credit enhancement, the Company is liable for losses on loans delivered to the Program after application of any mortgage insurance and a contractually agreed-upon credit enhancement provided by the Program subject to an agreed-upon maximum. The Company received a fee for this credit enhancement. The Company does not anticipate that any credit losses will be incurred in excess of anticipated credit enhancement fees.

# Bank Mutual Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

December 31, 2004

(Dollars in Thousands, Except Per Share Amounts)

### 14. Fair Value of Financial Instruments

Disclosure of fair value information about certain financial instruments, whether or not recognized in the consolidated financial statements, for which it is practicable to estimate the value, is summarized below. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques.

Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instrument.

Certain financial instruments and all nonfinancial instruments are excluded from this disclosure. Accordingly, the aggregate fair value of amounts presented does not represent the underlying value of the Company and is not particularly relevant to predicting the Company's future earnings or cash flows.

The following methods and assumptions are used by the Company in estimating its fair value disclosures of financial instruments:

*Cash and Cash Equivalents:* The carrying amounts reported in the statements of financial condition for cash and cash equivalents approximate those assets' fair values.

*Investment and Mortgage-Related Securities:* Fair values for these securities are based on quoted market prices or such prices of comparable instruments.

*Loans Receivable and Loans Held-for-Sale:* The fair value of one-to-four family fixed-rate mortgage loans was determined based on the current market price for securities collateralized by similar loans. For variable rate one-to-four family mortgage, consumer and other loans that reprice frequently and with no significant change in credit risk, carrying values approximate fair values. The fair value for fixed-rate commercial real estate, rental property mortgage, consumer and other loans was estimated by projecting cash flows at market interest rates.

*Mortgage Servicing Rights:* The Company has calculated the fair market value of mortgage servicing rights for those loans that are sold with servicing rights retained. For valuation purposes, loans are stratified by product type and, within product type, by interest rates. The fair value of mortgage servicing rights is based upon the present value of estimated future cash flows using current market assumptions for prepayments, servicing cost and other factors.

*Federal Home Loan Bank Stock:* Federal Home Loan Bank stock is carried at cost, which is its redeemable (fair) value, since the market for this stock is restricted.

*Accrued Interest Receivable:* The carrying value of accrued interest receivable approximates fair value.

*Deposits and Advance Payments by Borrowers for Taxes and Insurance:* Fair values for deposits are estimated using a discounted cash flow calculation that applies current market borrowing interest rates to a schedule of aggregated expected monthly maturities on deposits. The advance payments by borrowers for taxes and insurance are equal to their carrying amounts at the reporting date.

# Bank Mutual Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

December 31, 2004

(Dollars in Thousands, Except Per Share Amounts)

### 14. Fair Value of Financial Instruments (continued)

*Borrowings:* The fair value of long-term borrowings is estimated using discounted cash flow calculations with the discount rates equal to interest rates currently being offered for borrowings with similar terms and maturities. The carrying value on short-term borrowings approximates fair value.

	December 31 2004		December 31 2003	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Cash and cash equivalents	\$36,868	\$36,868	\$ 86,503	\$ 86,503
Investment and mortgage-related securities	1,334,977	1,334,977	1,121,182	1,121,182
Loans receivable, net	1,875,885	1,916,114	1,712,278	1,762,231
Loans held for sale	4,987	4,987	4,056	4,056
Mortgage servicing rights	4,542	5,659	4,698	4,698
Federal Home Loan Bank stock	38,186	38,186	35,498	35,498
Accrued interest receivable	11,352	11,352	10,820	10,820
Deposits and accrued interest	1,982,881	1,915,729	2,052,290	2,230,147
Advance payments by borrowers	2,796	2,796	2,987	2,987
Borrowings	761,525	754,994	299,491	338,122

The above table does not include any amount for the value of any off-balance-sheet items (see Note 12) since the fair value of these items is not significant.

# Bank Mutual Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

December 31, 2004

(Dollars in Thousands, Except Per Share Amounts)

### 15. Condensed Parent Company Only Financial Statements

#### STATEMENT OF FINANCIAL CONDITION

	December 31	
	2004	2003
<b>Assets:</b>		
Cash and cash equivalents	\$140,138	\$213,226
Investment in subsidiaries	519,548	509,747
Due from subsidiaries	6,392	1,995
Receivable from ESOP	4,847	5,747
Other assets	-	661
	<u>\$670,925</u>	<u>\$731,376</u>
<b>Liabilities and shareholders' equity:</b>		
<b>Liabilities:</b>		
Due to subsidiaries	\$ -	\$ -
Other liabilities	471	296
	<u>471</u>	<u>296</u>
<b>Shareholders' equity:</b>		
Preferred stock - \$.01 par value		
Authorized- 20,000,000 shares in 2004 and 2003	-	-
Issued and outstanding - none in 2004 and 2003	-	-
Common stock - \$.01 par value:		
Authorized - 200,000,000 shares in 2004 and 2003		
Issued - 78,783,849 shares in 2004 and 78,775,779 shares in 2003		
Outstanding - 73,485,113 in 2004 and 78,775,779 shares in 2003	788	788
Additional paid-in capital	495,858	495,990
Retained earnings	258,110	241,958
Unearned ESOP shares	(4,865)	(5,766)
Accumulated other comprehensive income	(4,844)	149
Unearned deferred compensation	(10,076)	(2,039)
Treasury stock -5,298,736 shares in 2004	(64,517)	-
Total shareholders' equity	<u>670,454</u>	<u>731,080</u>
	<u>\$670,925</u>	<u>\$731,376</u>

# Bank Mutual Corporation and Subsidiaries

## Notes to Consolidated Financial Statements (Continued)

December 31, 2004

(Dollars in Thousands, Except Per Share Amounts)

### 15. Condensed Parent Company Only Financial Statements (continued)

#### STATEMENT OF INCOME

	Year ended December 31	
	2004	2003
Interest income	\$ 2,735	\$ 1,723
Equity in earnings of subsidiaries	28,394	22,129
Gain on sale of investments	537	-
Other	5	7
Total income	31,671	23,859
Total expenses	1,335	944
Income before provision for income taxes	30,336	22,915
Provision for income taxes	782	316
Net income	\$29,554	\$ 22,599

#### STATEMENT OF CASH FLOWS

	Year ended December 31	
	2004	2003
Operating activities:		
Net income	\$ 29,554	\$ 22,599
Adjustment to reconcile net income to net cash provided by (used in) operating activities:		
Equity in earnings of subsidiaries	(28,394)	(22,129)
Amortization of cost of stock benefit plans	5,857	3,987
Decrease in due to subsidiaries	(4,397)	(5,450)
Change in other operating activities and liabilities	836	(1,215)
Net cash provided (used) in operating activities	3,456	(2,208)
Investing activities:		
Stock proceeds invested in subsidiary	-	(202,399)
Dividends from Company subsidiaries	13,600	9,600
Net cash provided (used) by investing activities	13,600	(192,799)
Financing activities:		
Sale of stock	-	404,753
Cash dividends	(13,402)	(5,925)
Purchase of treasury stock	(78,859)	(8,011)
Proceeds from exercise of stock options	1,217	940
Payments received on ESOP	900	900
Net cash provided (used) by financing activities	(90,144)	392,657
Increase (decrease) in cash and cash equivalents	(73,088)	197,650
Cash and cash equivalents at beginning of year	213,226	15,576
Cash and cash equivalents at end of year	\$140,138	\$213,226

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

Not applicable.

**Item 9A. Controls and Procedures**

**Disclosure Controls and Procedures:** Bank Mutual Corporation's management, with the participation of Bank Mutual Corporation's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of Bank Mutual Corporation's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. Based on such evaluation, Bank Mutual Corporation's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, Bank Mutual Corporation's disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by Bank Mutual Corporation in the reports that it files or submits under the Exchange Act.

**Change in Internal Control Over Financial Reporting:** There have not been any changes in the Bank Mutual Corporation's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the final fiscal quarter of the year to which this report relates that have materially affected, or are reasonably likely to materially affect, Bank Mutual Corporation's internal control over financial reporting.

**Management's Report on Internal Control over Financial Reporting**

The internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that: (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorization of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Management of Bank Mutual Corporation is responsible for establishing and maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Bank Mutual Corporation's management, including its chief executive officer and chief financial officer, has assessed the effectiveness of its internal control over financial reporting as of December 31, 2004, based on the criteria established in "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on their assessment and those criteria, management believes that as of December 31, 2004, Bank Mutual Corporation's internal control over financial reporting is effective.

Ernst & Young LLP, independent registered public accounting firm, has issued an attestation report on management's assessment of Bank Mutual Corporation's internal control over financial reporting. That attestation report can be found below as part of this Item 9A.

## **Ernst & Young LLP, Report on Effectiveness of Internal Control Over Financial Reporting**

Board of Directors  
Bank Mutual Corporation and Subsidiaries

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that Bank Mutual Corporation maintained effective internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Bank Mutual Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Bank Mutual Corporation maintained effective internal control over financial reporting as of December 31, 2004, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Bank Mutual Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2004, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of Bank Mutual Corporation and Subsidiaries as of December 31, 2004 and 2003 and the consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2004 Bank Mutual Corporation and our report dated January 28, 2005 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Milwaukee, Wisconsin

January 28, 2005

**Item 9B. Other Information.**

In late 2004, the Employment Agreements of Messrs. Anderegg, Callen, Colberg and Maurer, and Ms. Scholz, were extended for one year periods, through December 31, 2005, in accordance with the provisions of those agreements. The Employment Agreements of Messrs. Crowley Sr. and Jr. extended automatically, in accordance with their terms.



### Part III

#### **Item 10. Directors and Executive Officers of the Registrant**

Information in response to this item is incorporated herein by reference to "Election of Directors" and "Section 16(a) Beneficial Ownership Reporting Compliance" in Bank Mutual Corporation's definitive Proxy Statement for its Annual Meeting of Shareholders on May 2, 2005 (the "2005 Annual Meeting Proxy Statement"). See also "Executive Officers of the Registrant" in Part I hereof, which is incorporated herein by reference.

#### **Item 11. Executive Compensation**

Information in response to this item is incorporated by reference to "Directors' Compensation", "Executive Compensation," and "Compensation Committee Interlocks and Insider Participation" in the 2005 Annual Meeting Proxy Statement.

#### **Item 12. Security Ownership of Certain Beneficial Owners and Management**

Information in response to this item is incorporated by reference to "Security Ownership of Certain Beneficial Owners" and "Executive Compensation – Stock Options and Equity Compensation Plans – Equity Compensation Plan Information" in the 2005 Annual Meeting Proxy Statement.

#### **Equity Compensation Plan Information**

The following chart gives aggregate information regarding grants under all equity compensation plans of Bank Mutual Corporation through December 31, 2004.

<u>Plan category</u>	<u>Number of securities to be issued upon exercise of outstanding options, warrants and rights (1)</u>	<u>Weighted-average exercise price of outstanding options, warrants and rights</u>	<u>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in 1<sup>st</sup> column) (2)</u>
Equity compensation plans approved by security holders	5,276,953	\$6.5764	2,411,883
Equity compensation plans not approved by security holders	-0-	n/a	-0-
Total	5,276,953	\$6.5764	2,411,883

(1) Represents options granted under the 2001 Plan or 2004 Stock Incentive Plan, which were approved by Company shareholders in 2001 and 2004, respectively.

(2) Represents options or restricted stock which may be granted under the 2004 Plan. No further awards may be made under the 2001 Plan.

#### **Item 13. Certain Relationships and Related Transactions**

Information in response to this item is incorporated by reference to "Election of Directors," Compensation Committee Interlocks and Insider Participation" and "Certain Transactions with the Company" in the 2005 Annual Meeting Proxy Statement.

#### **Item 14. Principal Accountant Fees and Services**

Information in response to this item is incorporated by reference to "Independent Auditors" in the 2005 Annual Meeting Proxy Statement.

## Part IV

### **Item 15. Exhibits and Financial Statement Schedules**

(a) Documents filed as part of the Report:

1. and 2. Financial Statements and Financial Statement Schedules.

The following consolidated financial statements of Bank Mutual Corporation and subsidiaries are filed as part of this report under Item 8, "Financial Statements and Supplementary Data":

Consolidated Statements of Financial Condition - December 31, 2004 and 2003.

Consolidated Statements of Income - Years Ended December 31, 2004, 2003 and 2002.

Consolidated Statements of Changes In Shareholders' Equity - Years Ended December 31, 2004, 2003 and 2002.

Consolidated Statements of Cash Flows - Years Ended December 31, 2004, 2003 and 2002.

Notes to Consolidated Financial Statements.

Report of Ernst & Young LLP, Independent Auditors, on consolidated financial statements.

The Report of Ernst & Young LLP on effectiveness of internal control over financial reporting is filed as part of this report under Item 9A, "Controls and Procedures."

All schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are not required under the related instructions or are inapplicable, and therefore have been omitted.

(b). Exhibits. See Exhibit Index following the signature page of this report, which is incorporated herein by reference. Each management contract or compensatory plan or arrangement required to be filed as an exhibit to this report is identified in the Exhibit Index by an asterisk following its exhibit number.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

March 11, 2004

### BANK MUTUAL CORPORATION

By: /s/Michael T. Crowley, Jr.  
Michael T. Crowley, Jr.  
*Chairman, President and Chief Executive Officer*

## POWER OF ATTORNEY

Each person whose signature appears below hereby authorizes Michael T. Crowley, Jr., Rick B. Colberg, and Marlene M. Scholz, or any of them, as attorneys-in-fact with full power of substitution, to execute in the name and on behalf of such person, individually, and in each capacity stated below or otherwise, and to file, any and all amendments to this report.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated.\*

### Signature and Title

/s/Michael T. Crowley, Jr.  
Michael T. Crowley, Jr., *Chairman, President*  
*Chief Executive Officer and Director*  
*(Principal Executive Officer)*

/s/Raymond W. Dwyer, Jr.  
Raymond W. Dwyer, Jr., *Director*

/s/Rick B. Colberg  
Rick B. Colberg, *Chief Financial Officer*  
*(Principal Financial Officer)*

/s/Thomas J. Lopina, Sr.  
Thomas J. Lopina, Sr., *Director*

/s/Marlene M. Scholz  
Marlene M. Scholz, *Senior Vice President*  
*(Principal Accounting Officer)*

/s/William J. Mielke  
William J. Mielke, *Director*

/s/Thomas H. Buestrin  
Thomas H. Buestrin, *Director*

/s/Robert B. Olson  
Robert B. Olson, *Director*

/s/Mark C. Herr  
Mark C. Herr, *Director*

/s/David J. Rolfs  
David J. Rolfs, *Director*

/s/Jelmer G. Swoboda  
Jelmer G. Swoboda, *Director*

\* Each of the above signatures is affixed as of March 11, 2005.

**BANK MUTUAL CORPORATION**  
**("Bank Mutual Corporation" or the "Company")\*\***  
**Commission File No. 000-32107**

**EXHIBIT INDEX**  
**TO**  
**2004 REPORT ON FORM 10-K**

The following exhibits are filed with, or incorporated by reference in, this Report on Form 10-K for the year ended December 31, 2004:

<u>Exhibit</u>	<u>Description</u>	<u>Incorporated Herein By Reference To</u>	<u>Filed Herewith</u>
2.1	Plan of Restructuring of Bank Mutual Corporation and Bank Mutual Bancorp, MHC dated April 21, 2003, as amended and restated on July 7, 2003 (the "Plan")	Exhibit 2.1 to the Company's Registration Statement on Form S-1, Registration No. 333-105685 (the "2003 S-1")	
3(i)	Restated Articles of Incorporation, as last amended May 29, 2003, of Bank Mutual Corporation (the "Articles")	Exhibit 3(i) to 2003 S-1	
3(ii)	Bylaws, as last amended May 29, 2003, of Bank Mutual Corporation	Exhibit 3(ii) to 2003 S-1	
4.1	The Articles	Exhibit 3(i) above	
4.2	The Plan	Exhibit 2.1 above	
10.1*	Bank Mutual Corporation Savings Restoration Plan and Bank Mutual Corporation ESOP Restoration Plan	Exhibit 10.1(b) to the Company's Annual Report on Form 10-K for the year ended December 31, 2003 ("2003 10-K")	
10.2*	Mutual Savings Bank Outside Directors' Retirement Plan	Exhibit 10.2 to Bank Mutual Corporation's Registration Statement on Form S-1, Registration No. 333-39362 (the "2000 S-1")	
10.3*	Mutual Savings Bank Executive Excess Benefit Plan	Exhibit 10.3 to 2000 S-1	
10.4*	Agreement regarding deferred compensation dated May 16, 1988 between Mutual Savings Bank and Michael T. Crowley, Jr.	Exhibit 10.4 to 2000 S-1	
10.5(a)*	Employment Agreement between Mutual Savings Bank and Michael T. Crowley Jr.	Exhibit 10.5(a) to 2000 S-1	
10.5(b)*	Amendment thereto dated February 17, 1998	Exhibit 10.5(b) to 2000 S-1	

<u>Exhibit</u>	<u>Description</u>	<u>Incorporated Herein By Reference To</u>	<u>Filed Herewith</u>
10.6(a)*	Employment Agreement between Mutual Savings Bank and Michael T. Crowley, Sr. dated December 31, 1993	Exhibit 10.6(a) to 2000 S-1	
10.6(b)*	Amendment thereto dated February 17, 1998	Exhibit 10.6(b) to 2000 S-1	
10.7*	Form of Employment Agreements of Mr. Maurer, Ms. Scholz, Mr. Anderegg and Mr. Callen with Mutual Savings Bank, each dated as of January 1, 2001 (continuing through 2005)	Exhibit 10.7 to 2000 S-1	
10.8*	Resignation and Separation Agreement dated as of June 6, 2003 between Bank Mutual Corporation and Michael D. Meeuwsen	Exhibit 10.1 to Bank Mutual Corporation's Report on Form 8-K dated June 6, 2003	
10.9(a)*	Employment Agreement between First Northern Savings Bank and Rick B. Colberg dated as of November 1, 2000 (continuing, as amended, through 2005)	Exhibit 10.9 to Bank Mutual's Annual Report on Form 10-K for the year ended December 31, 2000 ("2000 10-K")	
10.9(b)*	Amendment thereto, dated as of August 2, 2002	Exhibit 10.9(b) to 2003 10-K	
10.9(c)*	Second Amendment thereto, dated as of August 19, 2003	Exhibit 10.9(c) to 2003 10-K	
10.10(a)*	Non-Qualified Deferred Retirement Plan for Directors of First Northern Savings Bank	Exhibit 10.10(a) to 2000 10-K	
10.10(b)*	Amendment No. 1 thereto	Exhibit 10.3.2 to First Northern Capital Corp.'s Annual Report on Form 10-K for the fiscal year ended December 31, 1998 ("FNCC 1998 10-K")	
10.11(a)*	Form of Supplemental Retirement Agreement dated as of January 1, 1994 between First Northern Savings Bank and Rick B. Colberg	Exhibit 10.11(a) to 2000 10-K	
10.11(b)*	Form of Amendment No. 1 thereto dated as of September 20, 1995	Exhibit 10.11(b) to 2000 10-K	
10.11(c)*	Form of Amendment No. 2 thereto, dated as of October 15, 1998	Exhibit 10.6.4 to FNCC 1998 10-K	
10.12*	Bank Mutual Corporation 2001 Stock Incentive Plan, as amended May 7, 2002 (superseded, except as to outstanding awards)	Exhibit 10.1 to Bank Mutual Corporation's Quarterly Report on Form 10-Q for the	

<u>Exhibit</u>	<u>Description</u>	<u>Incorporated Herein By Reference To</u> quarter ended March 31, 2002	<u>Filed Herewith</u>
10.13(a)*	Bank Mutual Corporation 2004 Stock Incentive Plan	Exhibit A to Proxy Statement for 2004 Annual Meeting of Shareholders	
10.13(b)*	Form of Option Agreement thereunder - Bank Mutual Corporation 2004 Director Stock Option Agreement	Exhibit 10.1(b) to the Company's Report on Form 10-Q for the quarter ended June 20, 2004 (6-30-04 10-Q")	
10.13(c)*	Form of Option Agreement thereunder - Bank Mutual Corporation 2004 Incentive Stock Option Agreement	Exhibit 10.1(c) to the 6-30-04 10-Q	
10.13(d)*	Form of Restricted Stock Agreement thereunder - Bank Mutual Corporation 2004 Directors Management Recognition Award	Exhibit 10.1(d) to the 6-30-04 10-Q	
10.13(e)*	Form of Restricted Stock Agreement thereunder - Bank Mutual Corporation 2004 Officers Management Recognition Award	Exhibit 10.1(e) to the 6-30-04 10-Q	
10.14*	Mutual Savings Bank/First Northern Savings Bank Management Incentive Compensation Plan	Exhibit 10.12(b) to Post-Effective Amendment No. 1 to 2003 S-1	
10.15(a)	Agency Agreement dated August 1, 2003 among Bank Mutual Corporation, Bank Mutual Bancorp, MHC and Ryan Beck	Exhibit 10.1 to Bank Mutual Corporation's Quarterly Report on Form 10-Q for the quarter ended June 30, 2003	
10.15(b)	Supplemental letter agreement with Ryan Beck relating to resolicitation	Exhibit 1.1(b) to Post-Effective Amendment No. 1 to 2003 S-1	
21.1	List of Subsidiaries		X
23.1	Consent of Ernst & Young LLP		X
24.1	Powers of Attorney	Signature Page	
31.1	Sarbanes-Oxley Act Section 302 Certification signed by the Chairman, President and Chief Executive Officer of Bank Mutual Corporation		X
31.2	Sarbanes-Oxley Act Section 302 Certification signed by the Chief Financial Officer of Bank Mutual Corporation		X

<u>Exhibit</u>	<u>Description</u>	<u>Incorporated Herein By Reference To</u>	<u>Filed Herewith</u>
32.1	Certification pursuant to 18 U.S. C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 signed by the Chairman, President and Chief Executive Officer of Bank Mutual Corporation		X
32.2	Certification pursuant to 18 U.S. C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 signed by the Chief Financial Officer of Bank Mutual Corporation		X

\* Designates management or compensatory agreements, plans or arrangements required to be filed as exhibits pursuant to Item 14(c) of Form 10-K

\*\* As used in this Exhibit Index, references to Bank Mutual Corporation and the Company also include, where appropriate, Bank Mutual Corporation, a federally-chartered corporation and the predecessor of the current registrant.

\*\*\* Mutual Savings Bank is now known as "Bank Mutual."